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IN THE
**Supreme Court of
The United States**

OCTOBER TERM, 1977

No. **77-1820**

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
AND TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioners,
v.
FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE DISTRICT OF COLUMBIA CIRCUIT**

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The Interstate Natural Gas Association of America (INGAA) and Texas Eastern Transmission Corporation (Texas Eastern)¹ hereby petition for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered in this case on March 28, 1978.

¹ INGAA is a non-profit national trade association whose membership includes virtually all of the major interstate pipeline companies subject to the jurisdiction of the Federal Energy Regulatory Commission under the Natural Gas Act, 15 U.S.C. § 717, *et. seq.* Texas Eastern is an interstate pipeline company (and a member of INGAA).

OPINIONS BELOW

The Memorandum Opinion of the Court of Appeals for the District of Columbia Circuit remanding the case to the Federal Power Commission for further proceedings and the final judgment of the court on review of the outcome of the remanded proceedings, not yet reported and not to be officially published, are printed in the Appendix (pp. 98-108 and 121-22) filed with this Petition. The opinions and orders of the Federal Power Commission and its successor, Federal Energy Regulatory Commission² are styled Order No. 505, 51 FPC 714 (1974), Order No. 505-A, 51 FPC 832 (1974), Order Denying Rehearing and Reconsideration, 51 FPC 1746 (1974), Order No. 505-B, issued July 8, 1977 in Docket No. R-424, and Order Denying Application For Rehearing of Order No. 505-B, issued September 7, 1977. The latter two Orders have not been officially reported. These opinions and orders are printed in the Appendix filed concurrently herewith at pp. 1-77, 84-88, 89-96, 108-18 and 119-20, respectively.

JURISDICTION

The judgment of the Court of Appeals for the District of Columbia Circuit was entered on March 28, 1978. The

² On September 30, 1977, pursuant to the provisions of the Department of Energy Organization Act, Public Law 95-91, 42 U.S.C. § 7101 (Aug. 4, 1977), and Executive Order No. 12009, 42 Fed. Reg. 46267 (Sept. 13, 1977), the Federal Power Commission (FPC) ceased to exist and most of its functions and regulatory responsibilities were transferred to the Federal Energy Regulatory Commission (FERC), which, as an independent Commission within the Department of Energy, was activated on October 1, 1977. Section 705(e) of the Organization Act, 42 U.S.C. § 7295, provides for the substitution of the FERC for the FPC as party-respondent in cases such as this. For the purposes of this brief, the term "Commission" when used in the context of an action taken or statement made prior to October 1, 1977, refers to the FPC; when used otherwise, the reference is to the FERC.

jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b).

QUESTION PRESENTED

Whether Commission Order Nos. 505, 505-A and 505-B, requiring regulated utilities to deviate from generally accepted accounting principles in reporting gains on reacquired securities are arbitrary and capricious, there being no ascertainable regulatory advantage to offset the added costs to the utilities and their consumers.

STATUTES INVOLVED

Involved are Sections 8, 16, and 19(b) of the Natural Gas Act, 15 U.S.C. §§ 717g(a), 717o, and 717r(b). These are set forth in the Appendix (pp. 123-25) to this Petition.

STATEMENT

This case does not involve rates or ratemaking principles except as the orders under review exert an *upward* pressure on capital costs and thus rates. Involved here is the Commission's requirement that the utilities depart from generally accepted accounting principles and amortize gains on reacquired securities over the remaining life of the issue (see Accounting Practices Board Opinion 26, issued October, 1972). This produces lower reported income and unnecessarily impairs the utilities' ability to attract capital.

Generally, when current interest rates are higher than those provided in outstanding securities, a company is able to repurchase such securities at a discount and to utilize the repurchased security to satisfy sinking fund requirements. As the repurchase transaction satisfies an obligation at an expenditure less than the face amount of

the obligation, generally accepted accounting principles provide for the entire gain being reflected as income in the year of the transaction. This had also been the Commission's position for the approximately thirty year period since the adoption of its Uniform System of Accounts.

In 1970, the Commission determined, in *Manufacturers Light and Heat Co., et al*, 44 FPC 314 (1970) that for rate purposes gains on reacquired securities could be normalized by amortizing the gain over the remaining life of the security.³

Thereafter, on August 6, 1971 the Commission issued a notice of proposed rulemaking entitled "Accounting For Premium, Discount And Expense Of An Issue, Gains And Losses On Refunding, And Reacquisition Of Long-Term Debt, And Interperiod Allocation Of Income Taxes" in Docket No. R-424. The rulemaking was instituted, *inter alia*, to promulgate new accounting methods for gains and losses on reacquired debt when no refunding is involved.

Despite comments almost universally opposing the proposed accounting change,⁴ the Commission issued Orders

³ The issue in *Manufacturers* involved the computation of Manufacturer's cost of debt capital. This is one of many factors, most of which are judgmental, taken into account in determining an appropriate rate of return (see Memorandum Op., App. 103-04).

⁴ The New York Public Service Commission argued that the rule was "not necessary" and that it had "no support in generally accepted accounting principles" Comments of State of New York PSC (App. 131-32). The State of Wisconsin Public Service Commission commented that the proposal was "inconsistent with just and reasonable accounting provisions for public utility enterprises [and] inconsistent with the generally accepted accounting principles..." It characterized it as "unnecessary as well as being incorrect". Comments of State of Wisconsin PSC (App. 126-27). The State of California likewise asserted that the proposal was "in conflict with generally accepted accounting principles" Comments of State of California (App. 127-31).

505, 505-A, and an Order Denying Rehearing and Reconsideration requiring that jurisdictional utilities use accounting procedures which would track the Commission's rate treatment of gains from reacquired debt stated in *Manufacturers*, i.e., required amortization. The only rationale advanced by the Commission for its action was a statement that it believed the financial statements of the regulated utilities should reflect the "economic effect of rates" and that the failure to require accounting treatment identical to that adopted for rate purposes would result in "distortions of financial statements." (App. 3).

Texas Eastern and INGAA appealed Orders Nos. 505, 505-A and the Order Denying Rehearing and Reconsideration to the United States Court of Appeals for the District of Columbia Circuit primarily on the grounds that the rule would have a severe adverse impact on the utilities' ability to attract capital and that it served no regulatory purpose. Following oral argument, in which counsel for the Commission inferred that the accounting rule would have some beneficial impact on rates, the court, *sua sponte*, directed the Commission to advise it whether Order No. 505 itself tended to affect rates and/or ratemaking in some circumstances and if so, in what circumstances and how (App. 97). In its reply, the Commission conceded: "In summary, Order No. 505 generally has no effect upon rates and/or ratemaking" (Se App. 103).

On September 18, 1975, the court reversed the Commission and remanded the record for further proceedings consistent with its memorandum opinion.

In such opinion the court stated that "we would be abdicating our judicial function were we to affirm on the basis of the materials before us. The Commission order under attack in this case provides only the most conclusory

justifications for the challenged rule . . ." (App. 99). The court instructed the Commission to prepare a new opinion if it intended to adhere to its previous orders. Specifically, the court directed the Commission to focus on and explain (1) the need for the accounting rule to preserve the rate-making principle set forth in *Manufacturers Light and Heat Company*, 44 FPC 314 (1970), (2) the need for the accounting rule to maintain surveillance of public utility rates, (3) the need for the accounting rule to avoid distortion in utilities' financial statements, (4) why Commission "policy" to use the same procedure for ratemaking and accounting should apply in this case, and (5) whether the expected benefits of the rule outweighed the harm foreseen, as shown in comments filed by the utilities. The court cautioned that the regulation should be withdrawn unless the Commission could demonstrate how the proposed accounting rule was necessary to preserve the ratemaking function, why failure to amortize for accounting purposes would make the financial reports of regulated pipelines misleading, and whether benefits of the rule outweighed the harm.

On July 8, 1977 the Commission issued Order No. 505-B in which it adhered to its previous decision to require amortization on reacquisition of long-term debt but did not undertake to comply with the court's instructions.⁵ It denied rehearing without further explanation. (App. 119-20).

On March 28, 1978, the Court of Appeals affirmed the Commission concluding, in a one page judgment, that it was

⁵ The Commission conceded that its new accounting rule could have significant impact on the utilities' ability to raise capital, but argued that no actual detriment had been shown. It conceded that "the rate policy under *Manufacturers* could be followed regardless of the accounting" but concluded without explanation that "consistency" between accounting and rate-making "facilitates the ratemaking process" and is necessary to "avoid financial reporting that obscures the economic realities of the ratemaking process" (App. 115-16).

"now of the view" that for reasons stated in Order No. 505-B the accounting rule expressed in Order Nos. 505, 505-A and 505-B was not arbitrary and capricious (App. 121-22).⁶

REASONS FOR GRANTING THE WRIT

The requested writ should be granted because

1. The accounting rule has a severe adverse impact on the ability of the utilities to attract capital with a resulting increase in cost to the consumers and is thus of extreme importance to them and to the consuming public which they serve.
2. There is no rational basis for the Commission's action. It arbitrarily exalts form over substance requiring symmetry between ratemaking decisions and accounting practices without regard to the consequences.
3. In the final analysis the lower court abdicated its judicial review function.

THE FINANCIAL IMPACT

Attracting capital has been, for several years, and is now a major problem confronting utilities. By its nature, the service which the utilities provide is capital intensive. Utilities typically offer about 40% of the new bonds offered each year in the United States.⁷ Long-term debt represents approximately 60% of the capitalization ratio of a typical gas transmission company. The amount and cost of new debt which a utility can issue is largely governed by its

⁶ Mr. Justice Clark, formerly of the Supreme Court of the United States, sat by designation on the original panel which remanded the case. He was replaced on his death by Circuit Judge Robb. The other Judges on the panel were Judges Wright and MacKinnon.

⁷ M. Farris & R. Sampson, *Public Utilities*, Chap. 13 (1973).

earnings, generally from the standpoint of investor confidence and specifically, from the standpoint of limitations customarily written into debt indentures. The accounting requirement of Order No. 505 thus has two significant adverse consequences for the utility and the consumer.

First, contrary to generally accepted accounting principles the utility is not permitted to reflect the entire gain in the year of the transaction. This has the effect of reducing interest coverages. It produces a lower return on equity and a lower earnings-per-share figure, thus making the securities of the utility less attractive vis-a-vis the securities of non-regulated businesses which reflect such gains currently. Patently the attraction of debt capital is enhanced by higher interest coverages. Artificially and arbitrarily requiring the utilities to report lower earnings, thus decreasing interest coverages, causes the utility's cost of debt capital, which is ultimately reflected in its rates, to be higher.

Secondly, under standard indenture provisions, a utility is limited to the amount of capital it can raise through debt financing. To the extent the utility is prohibited from issuing debt capital, it is forced to the issuance of equity securities, i.e., common stock. Equity financing involves a greater cost to the consumer than does debt financing.⁸

By limiting the utility's ability to issue debt capital and forcing a greater reliance on equity financing, the 505

⁸ Interest associated with debt is tax deductible, while dividends associated with equity are taxable. It is the ultimate consumer who must provide the funds to pay dividends just as he must provide the funds to pay interest. Assuming a 50% tax rate, the utility must collect \$2.00 in revenue from the consumer for each dollar it pays out in dividends, whereas it is only required to collect \$1.00 in revenues for each dollar paid in interest. Further, since debt requirements must be satisfied first, equity funds carry a greater risk and thus are available only at a greater cost.

Orders threaten significant increases in the cost of capital to the utility and thus, ultimately, to the consumer. The Commission does not dispute this. Its answer is that no showing has been made that the rule has "in fact, caused such result" (App. 118).

The problems presented by Order No. 505 arise at a particularly crucial time. For the past several years, gains from debt reacquisition have been at peak levels because of the deep discounts at which the low interest-bearing debt issues of the 1950's and the 1960's have been traded (R. 498). On the other hand, utility demands for capital are at their peak and are continuing to increase.⁹

The significant adverse impact of the rule is illustrated from the fact that during 1974 and 1975, its effect was to require eleven major gas transmission companies and their affiliates to reflect artificially reduced earnings in a total amount of \$54,281,000. This resulted in a reduction of borrowing capability for these two years in the total amount of approximately \$224,000,000 (App. 117).¹⁰ And to what end? Simply to achieve a sterile symmetry between the rate and accounting treatment of gains from reacquired securities.

The Commission's response to this substantial adverse impact is both cavalier and circular. It states in Order No. 505-B:

"The fact that the effect of our rule on reported net income is significant lends support to our position that

⁹ The American Gas Association forecasts that the investment of gas utilities alone through 2000 will exceed \$200 billion in 1977 dollars. *Energy Analysis*, American Gas Association, March 3, 1978.

¹⁰ This represents only the adverse impact on certain selected companies for the two years shown in the record. The total adverse impact has been substantially greater.

accounting and financial reporting needs to reflect the economic effects of the ratemaking processes" (App. 118).

It is not, of course, the economic effect of the rate-making process which causes the significant financial impact. It is the rule itself.

THE ARBITRARINESS OF THE COMMISSION'S ACTION

The petitioners submit that the Commission's Orders disclose no "rational connection between the facts found and the choice made". *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962).

The adverse financial impact of the rule on the utilities and the fact that it does not affect the ratemaking process are undisputed. The Commission replied to the court that "Order No. 505 generally has no effect on rates and/or ratemaking" (see App. 103). In Order No. 505-B, it stated that "the rate policy under *Manufacturers* could be followed regardless of the accounting" (App. 115). It recognized the "critical needs of utilities for capital at reasonable costs" (App. 118). The threat of forcing higher cost equity financing is also recognized: "Our adherence to accounting for gains (losses) in a manner consistent with the economic realities of the ratemaking process lower the total borrowing capacity of some companies and could conceivably cause a company to resort to equity financing" (App. 118). Finally, the Commission conceded that the "effect of [amortization] on reported net income is significant" (App. 118).

On the other side of the scale, there is literally no more than the Commission's capricious insistence that accounting treatment track the method which it approved in

Manufacturers for computing debt cost in the overall rate of return determination.

The New York Public Service Commission explains the matter succinctly in its comments. It states:

"Test year" regulation permits the regulatory agency to normalize such items for rate purposes if the test year amount as recorded on the books of account is not considered appropriate for regulating rates. *Many other items are not normalized. There is little justification for the FPC to adopt this improper accounting — it is not necessary.* The test year concept adjusted for known and anticipated changes is an adequate vehicle to accomplish for rate purposes what the FPC is apparently trying to accomplish by the proposed accounting. (App. 132).

The Commission itself says:

Under various circumstances, accounting treatment and ratemaking treatment must necessarily diverge, but we do not believe that this is one of them (App. 93).

It offers no rational explanation why it does not believe this is one of them, however.¹¹ Its statement that "accounting and financial statements of regulated utilities should reflect the economic effects of rates" (App. 3) is meaningless. Nor is the claimed need for "disclosure" a rational basis for the rule. Full and complete disclosure can be pro-

¹¹ Order No. 505-B discusses at length the necessity of having a Uniform System of Accounts and the matching of costs and revenues in the ratemaking process. Use is also made of the scare term "windfall profits" (see App. 115). This is apparently intended to create the impression that there is some rate implication involved here. There is none other than an inevitable increase in capital costs to the utilities with a resulting adverse impact on the consuming public they serve. Petitioners are not questioning the rate treatment of gains on reacquired securities. What petitioners are trying to avoid is an unnecessary Commission-induced increase in capital cost which can only have the effect of requiring increased rates.

vided without requiring artificially reduced earnings and handicapping the utilities in their efforts to attract capital.

Petitioners recognize the strictness of the standards involving judicial review of administrative orders. At the same time, however, the Commission's action must be rational to be valid. Here it is not. It serves no regulatory purpose.

THE LOWER COURT'S ABDICATION OF ITS REVIEW RESPONSIBILITIES

In its Memorandum Opinion of August 18, 1977, remanding the cases to the Commission, the court below stated:

We are loathe to reverse the Federal Power Commission's judgment in a somewhat arcane area of accounting regulations for public utilities, especially when we are uncertain about the confusion which a reversal might create. *Yet we would be abdicating our judicial function were we to affirm on the basis of the materials before us.* (emphasis supplied, App. 99).¹²

The court directed the Commission to explain why the rule was necessary if it intended to adhere to it. It stated:

We believe that an explanation is required when the FPC overrides both its own past practice and the thoroughly deliberated conclusion of the professional group most concerned with the accuracy of financial statements." (App. 106).

The court concluded:

Nowhere does the Commission explain why the costs incurred are outweighed by the rule's benefits.

¹² Arbitrary Commission action is not supportable on the ground that reversal would create "confusion". Still there would be no confusion as a result of reversal here. Past years' earnings would simply be restated and realized gains transferred to equity (see APB Opinion 20, issued July, 1971).

Of course, if the Commission can demonstrate that failure to amortize would make the financial reports misleading the fact that an accurate report would allow a company to issue less debt than would an inaccurate report is inconsequential. *See Appalachian Power Co. v. FPC, supra* 328 F.2d at 252. Similarly, if the Commission can explain how the accounting rule assists the Commission's efforts to carry out its assigned functions, balancing the assistance against the impact on the utilities' ability to raise capital should not be difficult. *If the Commission can meet neither of these prerequisites, this rule should be withdrawn.* (emphasis supplied, App. 108).

The rule was not withdrawn, however. Nor was the required explanation given. In Order No. 505-B, the Commission adhered to the amortization requirement, but, other than conceding it was not necessary for the preservation of the *Manufacturers'* rate principle, made no perceptible attempt to comply with the court's mandate. When the matter reached the court again, it affirmed without opinion. It merely recited in its judgment that it was "now of the view that the accounting rule promulgated by Order Nos. 505, 505-A and 505-B satisfies [the necessary and appropriate] standard" set forth in the Natural Gas Act for accounting rules, citing the same cases which it had cited in the decision remanding to the Commission (App. 122).¹³

Thus, in the final analysis, the lower court did abdicate its review function.

¹³ *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962); *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 218, 286 (1974).

CONCLUSION

The arbitrary nature of the rule and its adverse impact on the utility's ability to attract capital warrant review by this Court. The Interstate Natural Gas Association of America and Texas Eastern Transmission Corporation therefore respectfully request this Court to grant this petition for writ of certiorari.

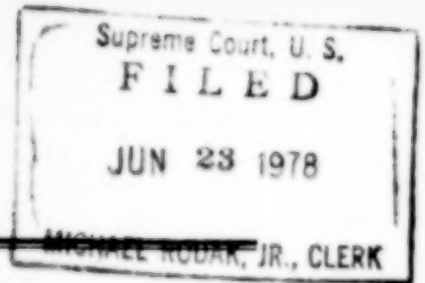
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UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR Parts 101, 104, §§ 141.1, 141.7, 141.25
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Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Rush
Moody, Jr., and William L.
Springer.

Accounting for Premium, Discount and Expense of Issue, Gains and Losses on Refunding and Reacquisition of Long-Term Debt, and Interperiod Allocation of Income Taxes	} Docket No. R-424

ORDER NO. 505

Order Implementing That Portion of Docket No. R-424 Relating to Accounting for Premium, Discount and Expense of Issue, Gains and Losses on Refunding and Reacquisition of Long-Term Debt.

(Issued February 11, 1974)

On August 6, 1971, the Commission issued a Notice of Proposed Rulemaking Docket No. R-424 (36 F.R. 16069, August 19, 1971) amended October 13, 1971 (36 F.R. 20445, October 22, 1971). This rulemaking essentially proposed to establish accounting procedures (a) for premium, discount and expense related to the issuance of long-term debt and for the gains and losses related to refunding and reacquisition of long-term debt and for (b) comprehensive interperiod tax allocation.

As a matter of convenience for all concerned, that portion of Docket No. R-424 dealing with long-term debt will be handled under this order. Since the remaining portion of Docket No. R-424 relating to interperiod tax allocation ties

in with Docket No. R-446 (37 F.R. 13805, July 14, 1972) containing interrelated tax matters.

Comments were invited from interested parties on Docket No. R-424 on or before October 5, 1971. Due to requests, this date was extended to September 3, 1972. The Commission received comments from sixty-seven respondents, Attachment A. Of these sixty-seven respondents, sixty-two addressed themselves to the long-term debt issues, see Attachment A.

Basically, the proposal concerned four major areas of accounting all having a relation to long-term debt. They were:

1. Accounting for premium, discount and expense of long-term debt.
2. Accounting for gains and losses on reacquired long-term, when no refunding is involved.
3. Accounting for gains and losses on reacquisition of long-term debt when a refunding is involved.
4. Adjusting retained earnings and restating balance sheets and income statements retroactively for a ten-year period, as effected by 2, above.

As to the proposal for the accounting and reporting change relating to premium, discount and expense of long-term debt, we are herein implementing the proposal as proposed. We believe that premiums and discounts are inseparable items from the long-term debt creating them and that reporting long-term debt in the aggregate on the balance sheet is a more practical and convenient method for determining not only the real long-term debt liability, but also the effective costs of funds derived from the sale of debt securities. There was little opposition to this proposal.

Concerning the proposal for the accounting and reporting changes relating to gains and losses on reacquiring long-term debt, when no refunding is involved, we are herein implementing the proposal as proposed with an amendment to allow accounting for these gains and losses on a current basis when a regulatory agency having rate jurisdiction over the utility does not require amortization of the gains and losses and apply them to embedded debt cost in determining the rate of return for rate setting purposes. We are aware that the Accounting Principles Board, Opinion No. 26 calls for these amounts to be accounted for in the current accounting period, however, we believe that the accounting and financial statements of a regulated utility should reflect the economic effects of rates, as provided for by the Addendum to the Accounting Principles Board's Opinion No. 2. We established a rate principle in Opinion No. 583, Manufacturer's Light and Heat Company, RP69-16, issued August 17, 1970 (44 FPC 314) that gains and losses relating to reacquisition of long-term debt should be amortized over the remaining life of the old debt and to deduct the amortization amount from the actual charges for interest to determine the true embedded cost of debt. Failure to provide accounting recognition of this significant ratemaking policy would result in distortions of financial statements.

On the other hand, relative to the above mentioned amendment, we are deeply concerned about the position in which utilities will be placed where a regulatory agency having rate jurisdiction does not consider the above referenced rate principle in establishing rates. It is believed a practical and equitable approach would be one whereby companies are allowed to account for gains and losses relating to reacquisition of long-term debt on a current accounting basis only when the amounts are not used in establishing rates as referenced above.

In connection with the proposal for accounting and reporting of gains and losses on reacquisition of long-term debt by refunding, we are convinced that accounting for this type item should be essentially the same as for the gains and losses concerned with the reacquisition of long-term debt when no refunding is involved, even though we realize the motives behind the two procedures may be somewhat different. Although we are deviating from the Accounting Principles Board Opinion No. 26, as aforementioned, for reacquisitions without refunding we do agree and support the principle that these two type transactions should be accounted for in a consistent manner. Therefore, since the accounting prescribed for reacquisitions without refunding is compelling, then the accounting in this case should follow suit. We are adopting the proposal as proposed.

And finally, we have decided to terminate the portion of the rule which requires restating balance sheets and income statements retroactively for a ten-year period. We do this primarily because of our concern about the impact it may have on the confidence of stockholders, potential investors, and financial analysts, and the fact that financial plans had been developed and decisions made using such statements.

We are also terminating the proposed amendment to Accounts 914, Revenues from Merchandising, Jobbing and Contract Work, and 915, Costs and Expenses of Merchandising, Jobbing and Contract Work, since these accounts were revoked by Docket No. R-445 (37 F.R. 24568, November 18, 1972). Also for consistency sake, it was necessary to apply account numbers 411.4 and 411.5 to the newly established Account 420, Investment Tax Credits (electric only, Order 454, issued July 6, 1972).

Certain constructive suggestions have been embodied in the changes to the Uniform System of Accounts such as

when a refunding technique has been selected it shall be followed consistently and that General Instruction 7 of the systems should contain a language change bringing it into line with the proposals. Certain other minor changes stemming from respondent suggestions, although not substantive in nature, were of considerable value in adding clarity to the accounting text language.

The Commission Finds:

(1) The notice and opportunity to participate in this rulemaking proceeding with respect to the matters presently before this Commission through the submission, in writing, of data, views, comments and suggestions in the manner as described above are consistent and in accordance with the procedural requirements prescribed by 5 U.S.C. 553.

(2) The amendments to Parts 101 and 104 of the Commission's Uniform System of Accounts for Public Utilities and Licensees, and Annual Report Forms No. 1, No. 1-F, No. 1-M, and No. 5 prescribed by Sections 141.1, 141.2, 141.7, and 141.25, respectively, in Chapter I, Title 18 of the Code of Federal Regulations, herein prescribed, are necessary and appropriate for the administration of the Federal Power Act.

(3) The amendments to Parts 201 and 204 of the Commission's Uniform System of Accounts for Natural Gas Companies and Annual Report Forms No. 2, No. 2-A, and No. 11 prescribed by Sections 260.1, 260.2, and 260.3, respectively, in Chapter I, Title 18 of the Code of Federal Regulations, herein prescribed, are necessary and appropriate for administration of the Natural Gas Act.

(4) Since the revisions prescribed herein which were not included in the notice of this proceeding, are consistent

with the prime purpose of the Proposed Rulemaking, further compliance with the notice provision of 5 U.S.C. 553 is unnecessary.

(5) Good cause exists for making the amendments to the Uniform Systems of Accounts for Public Utilities and Licensees and Natural Gas Companies ordered herein, effective January 1, 1973, and the amendments to FPC Annual Report Forms No. 1, No. 1-F, No. 1-M, No. 2, and No. 2-A effective for the reporting year 1973. The effective date of the amendments to FPC Forms No. 5 and No. 11 shall be effective upon issuance of this order.

The Commission, acting pursuant to the provisions of the Federal Power Act, as amended, particularly Sections 301, 302, 303, 304 and 309 thereof (49 Stat. 854-856, 859; 16 U.S.C. 825, 825a, 825b, 825c, 825h) and the Natural Gas Act, as amended, particularly Sections 8, 9, 10 and 16 thereof (52 Stat. 825, 826, 830; 15 U.S.C. 717g, 717h, 717i, 717o), orders:

(A.) That portion of the rulemaking proposed in this docket dealing with adjustments to retained earnings and restatement of balance sheet and income statements for a ten-year period, 1961 through 1970, and amendments to Account 114, Electric Plant Acquisition Adjustments, is hereby terminated.

(B.) That portion of the rulemaking proposed in this docket dealing with interperiod allocation of income taxes is hereby severed from the remainder of the rulemaking for separate Commission action. Also, that portion of the rulemaking having to do with amending Accounts 914, Revenues from Merchandising, Jobbing and Contract Work, and 915, Costs and Expenses of Merchandising, Jobbing and Contract Work, is terminated since these accounts were subsequently eliminated from the systems of accounts, Docket No. R-445 (37 F.R. 24658, November 18, 1972).

(C.) The Commission's Uniform System of Accounts for Class A and Class B Public Utilities and Licensees prescribed by Part 101, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

• • • • •

1. The General Instructions are amended:

(a) In instruction "2. *Records*." paragraph "E" is amended by deleting Account "426, Miscellaneous Income Deductions," and substituting Account 426.5, Other Deductions, therefor.

(b) In instruction "7. *Extraordinary Items*." the text is amended by amending the first sentence.

(c) Immediately following instruction "16. *Separate Accounts or Records for Each Licensed Project*." a new instruction "17. *Long-Term Debt: Premium, Discount and Expense and Gain or Loss on Reacquisition*." is added.

As so amended these portions of the General Instructions read as follows:

GENERAL INSTRUCTIONS

• • • • •

2. Records

• • • • •

E. All amounts included in the accounts prescribed herein for electric plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.

• • • • •

7. *Extraordinary Items*. It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described

in paragraph 7.1 and long-term debt as described in paragraph 17 below. . . .

.

17. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

A. *Premium, discount and expense* — A separate premium, discount and expense account shall be maintained for each class and series of long-term debt (including receivers' certificates) issued or assumed by the utility. The premium will be recorded in account 225, Unamortized Premium on Long-Term Debt, the discount will be recorded in account 226, Unamortized Discount on Long-Term Debt-Debit, and the expense of issuance shall be recorded in account 181, Unamortized Debt Expense.

The premium, discount and expense shall be amortized over the life of the respective issues under a plan which will distribute the amounts equitably over the life of the securities. The amortization shall be on a monthly basis, and amounts thereof relating to discount and expense shall be charged to account 428, Amortization of Debt Discount and Expense. The amounts relating to premium shall be credited to account 429, Amortization of Premium on Debt-Credit.

B. *Reacquisition, without refunding* — When long-term debt is reacquired or redeemed without being converted into another form of long-term debt and when the transaction is not in connection with a refunding operation (primarily redemptions for sinking fund purposes), the difference between the amount paid upon reacquisition and the face value; plus any unamortized premium less any related unamortized debt expense and reacquisition costs; or less any unamortized discount, related debt expense and reacquisition costs applicable to the debt redeemed, retired

and canceled, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility shall amortize the recorded amounts equally on a monthly basis over the remaining life of the respective security issues (old original debt). The amounts so amortized shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt-Credit, as appropriate.

C. *Reacquisition, with refunding* — When the redemption of one issue or series of bonds or other long-term obligations is financed by another issue or series before the maturity date of the first issue, the difference between the amount paid upon refunding and the face value; plus any unamortized premium less related debt expense or less any unamortized discount and related debt expense, applicable to the debt refunded, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility may elect to account for such amounts as follows:

(1) Write them off immediately when the amounts are insignificant.

(2) Amortize them by equal monthly amounts over the remainder of the original life of the issue retired, or

(3) Amortize them by equal monthly amounts over the life of the new issue.

Once an election is made, it shall be applied on a consistent basis. The amounts in (1), (2) or (3) above shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt-Credit, as appropriate.

D. Under methods (2) and (3) above, the increase or reduction in current income taxes resulting from the reacquisition should be apportioned over the remainder of the original life of the issue retired or over the life of the new issue, as appropriate, as directed more specifically in paragraphs E and F below.

E. When the utility recognizes the loss in the year of reacquisition as a tax deduction, account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited and account 283, Accumulated Deferred Income Taxes-Other, shall be credited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 283.

F. When the utility chooses to recognize the gain in the year of reacquisition as a taxable gain, account 411.1, Provision for Deferred Income Taxes-Credit, Utility Operating Income, shall be credited and account 190, Accumulated Deferred Income Taxes, shall be debited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 190.

G. When the utility chooses to use the optional privilege of deferring the tax on the gain attributable to the reacquisition of debt by reducing the depreciable basis of utility property for tax purposes, pursuant to Section 108 of the Internal Revenue Code, the related tax effects shall be deferred as the income is recognized for accounting purposes, and the deferred amounts shall be amortized over the life of the associated property on a vintage year basis. Account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited, and account 283, Accumulated Deferred Income Taxes-Other, shall be credited with an amount equal to the estimated income tax effect applicable to the portion of the income, attributable

to reacquired debt, recognized for accounting purposes during the period. Account 283 shall be debited and account 411.1, Provision for Deferred Income Taxes-Credit, Utility Operating Income, shall be credited with an amount equal to the estimated income tax effects, during the life of the property, attributable to the reduction in the depreciable basis for tax purposes.

H. The tax effects relating to gain or loss shall be allocated as above to utility operations except in cases where a portion of the debt reacquired is directly applicable to non-utility operations. In that event, the related portion of the tax effects shall be allocated to nonutility operations. Where it can be established that reacquired debt is generally applicable to both utility and nonutility operations, the tax effects shall be allocated between utility and nonutility operations based on the ratio of net investment in utility plant to net investment in nonutility plant.

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 419.1, Allowance for Funds Used During Construction.

J. *Alternate method* — Where a regulatory authority or a group of regulatory authorities having prime rate jurisdiction over the utility specifically disallows the rate principle of amortizing gains or losses on reacquisition of long-term debt without refunding, and does not apply the gain or loss to reduce interest charges in computing the allowed rate of return for rate purposes, then the following alternate method may be used to account for gains or losses relating to reacquisition of long-term debt, with or without refunding.

(1) The difference between the amount paid upon reacquisition of any long-term debt and the face value, adjusted

for unamortized discount, expenses or premium, as the case may be, applicable to the debt redeemed shall be recognized currently in income and recorded in account 421, Miscellaneous Nonoperating Income, or account 426.5, Other Deductions.

(2) When this alternate method of accounting is used, the utility shall include a footnote to each financial statement, prepared for public use, explaining why this method is being used along with the treatment given for ratemaking purposes.

(2.) The Chart of Balance Sheet Accounts is amended:

(a) By revising account title "181, Unamortized Debt Discount and Expense." to read "181, Unamortized Debt Expense."

(b) Immediately following account "188, Research and Development Expenditures," add new account 189, Unamortized Loss on Reacquired Debt.

(c) Immediately following account "224, Other Long-Term Debt," add two new accounts titled, 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt-Debit.

(d) By revoking account "251, Unamortized Premium on Debt."

(e) Immediately following account title "256, Deferred Gains from Disposition of Utility Plant," add account title 257, Unamortized Gain on Reacquired Debt.

As so amended those portions of the Chart of Balance Sheet Accounts read:

BALANCE SHEET ACCOUNTS

(Chart of Accounts)

ASSETS AND OTHER DEBITS

• • • • •

4. Deferred Debits

181 Unamortized debt expense.

• • • • •

189 Unamortized loss on reacquired debt.

• • • • •

LIABILITIES AND OTHER CREDITS

• • • • •

6. Long-Term Debt

• • • • •

225 Unamortized premium on long-term debt.

226 Unamortized discount on long-term debt — Debit.

• • • • •

8. Deferred Credits

251 [Revoked]

• • • • •

257 Unamortized gain on reacquired debt.

• • • • •

(3.) The balance sheet accounts are amended:

(a) Revise account title and text of account "181, Unamortized Debt Discount and Expense." As revised, account 181 reads:

181 Unamortized debt expense.

This account shall include expenses related to the issuance or assumption of debt securities. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall

be on a monthly basis, and the amounts thereof shall be charged to account 428, Amortization of Debt Discount and Expense. Any unamortized amounts outstanding at the time that the related debt is prematurely reacquired shall be accounted for as indicated in General Instruction 17.

(b) Immediately following account "188, Research and Development Expenditures," add a new account title 189, unamortized Loss on Reacquired Debt, to read as follows:

189 Unamortized loss on reacquired debt.

This account shall include the losses on long-term debt reacquired or redeemed. The amounts in this account shall be amortized in accordance with General Instruction 17.

(c) Revise paragraph B of account "222, Reacquired Bonds." As revised, this portion of account 222 reads:

222 Reacquired bonds.

A. . . .

B. When bonds are reacquired, the difference between face value, adjusted for unamortized discount, expenses or premium, and the amount paid upon reacquisition, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. (See General Instruction 17.)

(d) Immediately following account "224, Other Long-Term Debt," add new accounts titled 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt-Debit, to read as follows:

225 Unamortized premium on long-term debt.

A. This account shall include the excess of the cash value of consideration received over the face value upon the issuance or assumption of long-term debt securities.

B. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, with the amounts thereof to be credited to account 429, Amortization of Premium on Debt-Credit. (See General Instruction 17.)

226 Unamortized discount on long-term debt-Debit.

A. This account shall include the excess of the face value of long-term debt securities over the cash value of consideration received therefor, related to the issue or assumption of all types and classes of debt.

B. Amounts recorded in this account shall be amortized over the life of the respective issues under a plan which will distribute the amount equitably over the life of the securities. The amortization shall be on a monthly basis, with the amounts thereof charged to account 428, Amortization of Debt Discount and Expense. (See General Instruction 17).

(e) Revoke account "251, Unamortized Premium on Debt."

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate reference to account 411.3, Investment Tax Credit Adjustments and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations." As amended account 255 reads:

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have elected to follow deferral accounting, partial or full, rather than recognizing

in the income statement the total benefits of the tax credit as realized. After such election, a company may not transfer amounts from this account, except as authorized herein and in accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, 411.5, Investment Tax Credit Adjustments, Nonutility Operations, and 420, Investment Tax Credits, or with approval of the Commission.

B. Where the company's accounting provides that investment tax credits are to be passed on to customers, this account shall be debited and account 411.4 credited with a proportionate amount determined in relation to the average useful life of electric utility property to which the tax credits relate or such lesser period of time as allowed by a regulatory agency having rate jurisdiction. If, however, the deferral procedure provides that investment tax credits are not to be passed on to customers, the proportionate restorations to income shall be credited to account 420.

• • • • •

(g) Immediately following account "256, Deferred Gains from Disposition of Utility Plant," add a new account 257, Unamortized Gain on Reacquired Debt. As so amended, this portion of the balance sheet accounts reads:

257 Unamortized gain on reacquired debt.

This account shall include the amounts of discount realized upon reacquisition or redemption of long-term debt. The amounts in this account shall be amortized in accordance with General Instruction 17.

(4) The Chart of Income Accounts are amended as follows:

(a) Immediately following account "411.1, Income Taxes Deferred in Prior Years-Credit, Utility Operating Income," revoke account title "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "425, Miscellaneous Amortization," revoke account title "426, Miscellaneous Income Deductions."

(c) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(d) Immediately following account "429, Amortization of Premium on Debt-Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt-Credit.

As so amended the Chart of Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

• • • • •

Operating Expenses

• • • • •

411.3 [Revoked]

• • • • •

2. Other Income and Deductions

• • • • •

B. Other Income Deductions

• • • • •

426 [Revoked]

• • • • •

3. Interest Charges

• • • • •

428.1 Amortization of loss on reacquired debt.

• • • • •

429.1 Amortization of gain on reacquired debt-Credit.

• • • • •

(5.) The text of the Income Accounts are amended and revised as follows:

(a) Revoke account "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "411.2, Provision for Deferred Income Taxes-Credit, Other Income and Deductions," add *Special Instructions-Accounts 411.4 and 411.5*, with text.

(c) Revise the text of accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

(d) Amend subparagraph (a) of account "420, Investment Tax Credits," by deleting the reference to account "411.3, Investment Tax Credit Adjustments," and substituting therefor a reference to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations.

(e) In account "421, Miscellaneous Nonoperating Income," amend item 3 by a phrase to the end of the item.

(f) Revoke account "426, Miscellaneous Income Deductions."

(g) Immediately following account "425, Miscellaneous Amortization," add *Special Instructions-Accounts 426.1, 426.2, 426.3, 426.4 and 426.5* with text.

(h) In account "426.5, Other Deductions," amend item "3."

(i) In account "428, Amortization of Debt Discount and Expense," revise the last sentence of paragraph A.

(j) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(k) In account "429, Amortization of Premium on Debt-Credit," revise the last sentence of paragraph A.

(l) Immediately following account "429, Amortization of Premium on Debt-Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt-Credit.

As so amended this portion of the text of the Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

• • • • •

411.3 [Revoked]

Special Instructions — Accounts 411.4 and 411.5

A. Account 411.4 shall be debited with the amounts of investment tax credits related to electric utility property that are credited to account 255, Accumulated Deferred Investment Tax Credits, by companies which do not apply the entire amount of the benefits of the investment credit as a reduction of the overall income tax expense in the year in which such credit is realized (see account 255).

B. Account 411.4 shall be credited with the amounts debited to account 255 for proportionate amounts of tax credit deferrals allocated over the average useful life of electric utility property to which the tax credits relate or such lesser period of time as may be adopted and consistently followed by the company.

C. Account 411.5 shall be debited and credited as directed in paragraphs A and B, for investment tax credits related to nonutility property.

411.4 Investment tax credit adjustments, utility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Utility Operations (by department).

411.5 Investment tax credit adjustments, nonutility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Non-utility Operations.

• • • • •
2. Other Income and Deductions

• • • • •
420 Investment tax credits.

• • • • •
(a) By amounts equal to debits to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations, for investment tax credits used in calculating income taxes for the year when the company's accounting provides for nondeferral of all or a portion of such credits; and,

(b) • • •

421 Miscellaneous nonoperating income.

• • • • •
Items

• • • • •
3. Gains on disposition of investments. Also, gains on reacquisition and resale or retirement of utilities debt securities when the gain is not amortized and used by a jurisdictional regulatory agency to reduce embedded debt cost in establishing rates. See General Instruction 17.

• • • • •
426 [Revoked]

Special Instructions — Accounts 426.1, 426.2, 426.3, 426.4 and 426.5

These accounts shall include miscellaneous expense items which are nonoperating in nature but which are properly deductible before determining total income before interest charges.

Note: The classification of expenses as nonoperating and their inclusion in these accounts is for accounting purposes. It does not preclude Commission consideration of proof to the contrary for ratemaking or other purposes.

• • • • •
426.5 Other deductions

• • • • •
Items

• • • • •
3. Loss on reacquisition, resale or retirement of utility's debt securities, when the loss is not amortized and used by a jurisdictional regulatory agency to increase embedded debt cost in establishing rates. See General Instruction 17.

• • • • •
3. Interest Charges

• • • • •
428 Amortization of debt discount and expense.

A. • • • Amounts charged to this account shall be credited concurrently to accounts 181, Unamortized Debt Expense, and 226, Unamortized Discount on Long-Term Debt-Debit.

• • • • •
428.1 Amortization of loss on reacquired debt.

A. This account shall include the amortization of the losses on reacquisition of debt. Amounts charged to this

account shall be credited concurrently to account 189, Unamortized Loss on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the loss amortized applicable to each class and series of long-term debt reacquired. See General Instruction 17.

.

429 Amortization of premium on debt-Credit.

A. Amounts credited to this account shall be charged concurrently to account 225, Unamortized Premium on Long-Term Debt.

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429.1 Amortization of gain on reacquired debt-credit.

A. This account shall include the amortization of the gains realized from reacquisition of debt. Amounts credited to this account shall be charged concurrently to account 257, Unamortized Gain on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the gains amortized applicable to each class and series of long-term debt reacquired. See General Instruction 17.

(6.) Revise the Operation and Maintenance Expense Accounts by deleting the words "Discount and" from Note B of account "928, Regulatory Commission Expenses." As revised, Note B of account 928 reads:

928 Regulatory commission expenses.

.

Note B: Do not include in this account amounts includible in account 302, Franchises and Consents, account 181, Unamortized Debt Expense, or account 214, Capital Stock Expense.

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(D) The Commission's Uniform System of Accounts for

Class C and Class D Public Utilities and Licensees prescribed by Part 104, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1.) The General Instructions are amended:

(a) In instruction "2. *Records*." paragraph E is amended by deleting Account "426, Miscellaneous Income Deductions," and substituting Account 426.5, Other Deductions, therefor.

(b) In instruction "8. *Extraordinary Items*." the text is amended by amending the first sentence.

(c) Immediately following instruction "14. *Separate Accounts or Records for Each Licensed Project*." a new instruction "15. *Long-Term Debt: Premium, Discount and Expense and Gain or Loss on Reacquisition*." is added.

As so amended these portions of the General Instructions read as follows:

GENERAL INSTRUCTIONS

.

2. Records

.

E. All amounts included in the accounts prescribed herein for electric plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.

.

8. *Extraordinary Items*. It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described

in paragraph 9 and long-term debt as described in paragraph 15 below. . . .

• • • • •
15. *Long-Term Debt: Premium, Discount and Expense and Gain or Loss on Reacquisition.*

A. *Premium, discount and expense* — A separate premium, discount, and expense account shall be maintained for each class and series of long-term debt (including receivers' certificates) issued or assumed by the utility. The premium will be recorded in account 225, Unamortized Premium on Long-Term Debt, the discount will be recorded in account 226 Unamortized Discount on Long-Term Debt-Debit, and the expense of issuance shall be recorded in account 181, Unamortized Debt Expense.

The premium, discount and expense shall be amortized over the life of the respective issues under a plan which will distribute the amounts equitably over the life of the securities. The amortization shall be on a monthly basis, and amounts thereof relating to discount and expense shall be charged to account 428, Amortization of Debt Discount and Expense. The amounts relating to premium shall be credited to account 429, Amortization of Premium on Debt-Credit.

B. *Reacquisition, without refunding* — When long-term debt is reacquired or redeemed without being converted into another form of long-term debt and when the transaction is not in connection with a refunding operation (primarily redemption for sinking fund purposes), the difference between the amount paid upon reacquisition and the face value; plus any unamortized premium less any related unamortized debt expense and reacquisition costs; or less any unamortized discount, related debt expense and reacquisi-

tion costs applicable to the debt redeemed, retired and canceled, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt as appropriate. The utility shall amortize the recorded amounts equally on a monthly basis over the remaining life of the respective security issues (old original debt). The amounts so amortized shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt-Credit, as appropriate.

C. *Reacquisition, with refunding* — When the redemption of one issue or series of bonds or other long-term obligations is financed by another issue or series before the maturity date of the first issue, the difference between the amount paid upon refunding and the face value; plus any unamortized premium less related debt expense or less any unamortized discount and related debt expense, applicable to the debt refunded, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility may elect to account for such amounts as follows:

(1) Write them off immediately when the amounts are insignificant.

(2) Amortize them by equal monthly amounts over the remainder of the original life of the issue retired, or

(3) Amortize them by equal monthly amounts over the life of the new issue.

Once an election is made, it shall be applied on a consistent basis. The amounts in (1), (2) or (3) above shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt-Credit, as appropriate.

D. Under methods (2) and (3) above, the increase or reduction in current income taxes resulting from the reacquisition should be apportioned over the remainder of the original life of the issue retired or over the life of the new issue, as appropriate, as directed more specifically in paragraphs E and F below.

E. When the utility recognizes the loss in the year of reacquisition as a tax reduction, account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited and account 283, Accumulated Deferred Income Taxes-Other, shall be credited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 283.

F. When the utility chooses to recognize the gain in the year of reacquisition as a taxable gain, account 411.1, Provision for Deferred Income Taxes-Credit, Utility Operating Income, shall be credited and account 190, Accumulated Deferred Income Taxes, shall be debited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 190.

G. When the utility chooses to use the optional privilege of deferring the tax on the gain attributable to the reacquisition of debt by reducing the depreciable basis of utility property for tax purposes, pursuant to Section 108 of the Internal Revenue Code, the related tax effects shall be deferred as the income is recognized for accounting purposes, and the deferred amounts shall be amortized over the life of the associated property on a vintage year basis. Account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited, and account 283, Accumulated Deferred Income Taxes-Other, shall be credited with an amount equal to the estimated income tax effect applicable to the portion of the income, attributable

to reacquired debt, recognized for accounting purposes during the period. Account 283 shall be debited and account 411.1, Provision for Deferred Income Taxes-Credit, Utility Operating Income, shall be credited with an amount equal to the estimated income tax effects, during the life of the property, attributable to the reduction in the depreciable basis for tax purposes.

H. The tax effects relating to gain or loss shall be allocated as above to utility operations except in cases where a portion of the debt reacquired is directly applicable to non-utility operations. In that event, the related portion of the tax effects shall be allocated to nonutility operations. Where it can be established that reacquired debt is generally applicable to both utility and nonutility operations, the tax effects shall be allocated between utility and nonutility operations based on the ratio of net investment in utility plant to net investment in nonutility plant.

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 419.1, Allowance for Funds Used During Construction.

J. *Alternate method* — Where a regulatory authority or a group of regulatory authorities having prime rate jurisdiction over the utility specifically disallows the rate principle of amortizing gains or losses on reacquisition of long-term debt without refunding, and does not apply the gain or loss to reduce interest charges in computing the allowed rate of return for rate purposes, then the following alternate method may be used to account for gains or losses relating to reacquisition of long-term debt, with or without refunding.

(1) The difference between the amount paid upon reacquisition of any long-term debt and the face value, adjusted

for unamortized discount, expenses or premium, as the case may be, applicable to the debt redeemed shall be recognized currently in income and recorded in account 421, Miscellaneous Nonoperating Income, or account 426.5, Other Deductions.

(2) When this alternate method of accounting is used, the utility shall include a footnote to each financial statement, prepared for public use, explaining why this method is being used along with the treatment given for ratemaking purposes.

(2.) The Chart of Balance Sheet Accounts is amended:

(a) By revising account title "181, Unamortized Debt Discount and Expense," to read "181, Unamortized Debt Expense."

(b) Immediately following account "187, Deferred Losses from Disposition of Utility Plant," add new account 189, Unamortized Loss on Reacquired Debt.

(c) Immediately following account "224, Other Long-Term Debt," add two new accounts titled, 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt-Debit.

(d) By revoking account "251, Unamortized Premium on Debt."

(e) Immediately following account title "256, Deferred Gains from Disposition of Utility Plant," add account title 257, Unamortized Gain on Reacquired Debt.

As so amended, those portions of the Chart of Balance Sheet Accounts read:

BALANCE SHEET ACCOUNTS

(Chart of Accounts)

ASSETS AND OTHER DEBITS

• • • • •

4. Deferred Debits

181 Unamortized debt expense.

• • • • •

189 Unamortized loss on reacquired debt.

• • • • •

LIABILITIES AND OTHER CREDITS

• • • • •

6. Long-Term Debt

• • • • •

225 Unamortized premium on long-term debt.

226 Unamortized discount on long-term debt — Debit.

• • • • •

8. Deferred Credits

251 [Revoked]

• • • • •

257 Unamortized gain on reacquired debt.

• • • • •

(3.) The balance sheet accounts are amended:

(a) Revise account title and text of account "181, Unamortized Debt Discount and Expense." As revised, account 181 reads:

181 Unamortized debt expense.

This account shall include expenses related to the issuance or assumption of debt securities. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amor-

tization shall be on a monthly basis, and the amounts thereof shall be charged to account 428, Amortization of Debt Discount and Expense. Any unamortized amounts outstanding at the time that the related debt is prematurely reacquired shall be accounted for as indicated in General Instruction 15.

(b) Immediately following account "187, Deferred Losses from Disposition of Utility Plant," add a new account titled 189, Unamortized Loss on Reacquired Debt, to read as follows:

189 Unamortized loss on reacquired debt.

This account shall include the losses on long-term debt reacquired or redeemed. The amounts in this account shall be amortized in accordance with General Instruction 15.

(c) Revise paragraph B of account "221, Bonds." As revised, this portion of account 221 reads:

221 Bonds.

A.

B. When bonds are required, the difference between face value, adjusted for unamortized discount, expenses or premium, and the amount paid upon reacquisition, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. (See General Instruction 15.)

(d) Immediately following account "224, Other Long-Term Debt," add new accounts titled 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt-Debit, to read as follows:

225 Unamortized premium on long-term debt.

A. This account shall include the excess of the cash value of consideration received over the face value upon the issuance or assumption of long-term debt securities.

B. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, with the amounts thereof to be credited to account 429, Amortization of Premium on Debt-Credit. (See General Instruction 15.)

226 Unamortized discount on long-term debt-Debit.

A. This account shall include the excess of the face value of long-term debt securities over the cash value of consideration received therefor, related to the issue or assumption of all types and classes of debt.

B. Amounts recorded in this account shall be amortized over the life of the respective issues under a plan which will distribute the amount equitably over the life of the securities. The amortization shall be on a monthly basis, with the amounts thereof charged to account 428, Amortization of Debt Discount and Expense. (See General Instruction 15.)

(e) Revoke account "251, Unamortized Premium on Debt."

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits." to eliminate reference to account 411.3, Investment Tax Credit Adjustments and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations." As amended account 255 reads:

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have elected to follow deferral accounting, partial or full, rather than recognizing in the income statement the total benefits of the tax credit as realized. After such election, a company may not transfer amounts from this account, except as authorized herein

and in accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, 411.5, Investment Tax Credit Adjustments, Nonutility Operations, and 420, Investment Tax Credits, or with approval of the Commission.

B. Where the company's accounting provides that investment tax credits are to be passed on to customers, this account shall be debited and account 411.4 credited with a proportionate amount determined in relation to the average useful life of electric utility property to which the tax credits relate or such lesser period of time as allowed by a regulatory agency having rate jurisdiction. If, however, the deferral procedure provides that investment tax credits are not to be passed on to customers, the proportionate restorations to income shall be credited to account 420.

• • • • •

(g) Immediately following account "256, Deferred Gains from Disposition of Utility Plant," add a new account 257, Unamortized Gain on Reacquired Debt. As so amended, this portion of the balance sheet accounts reads:

257 Unamortized gain on reacquired debt.

This account shall include the amounts of discount realized upon reacquisition or redemption of long-term debt. The amounts in this account shall be amortized in accordance with General Instruction 15.

(4) The Chart of Income Accounts are amended as follows:

(a) Immediately following account "411.1, Income Taxes Deferred in Prior Years-Credit, Utility Operating Income," revoke account title "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "425, Miscellaneous Amortization," revoke account title "426, Miscellaneous Income Deductions."

(c) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(d) Immediately following account "429, Amortization of Premium on Debt-Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt-Credit.

As so amended the Chart of Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

• • • • •

Operating Expenses

• • • • •

411.3 [Revoked]

• • • • •

2. Other Income and Deductions

• • • • •

B. Other Income Deductions

• • • • •

426 [Revoked]

• • • • •

3. Interest Charges

• • • • •

428.1 Amortization of loss on reacquired debt.

• • • • •

429.1 Amortization of gain on reacquired debt-Credit.

• • • • •

(5) The text of the Income Accounts are amended and revised as follows:

(a) Revoke account "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "411.2, Provision for Deferred Income Taxes-Credit, Other Income and Deductions," add *Special Instructions-Accounts 411.4 and 411.5*, with text.

(c) Revise the text of accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

(d) Amend subparagraph (a) of account "420, Investment Tax Credits," by deleting the reference to account "411.3, Investment Tax Credit Adjustments," and substituting therefor a reference to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations.

(e) In account "421, Miscellaneous Nonoperating Income," amend item 3 by a phrase to the end of the item.

(f) Revoke account "426, Miscellaneous Income Deductions."

(g) Immediately following account "425, Miscellaneous Amortization," add *Special Instructions-Accounts 426.1, 426.2, 426.3, 426.4, and 426.5* with text.

(h) In account "426.5, Other Deductions," amend item "3."

(i) In account "428, Amortization of Debt Discount and Expense," revise the last sentence of paragraph A.

(j) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(k) In account "429, Amortization of Premium on Debt-Credit," revise the last sentence of paragraph A.

(l) Immediately following account "429, Amortization of Premium on Debt-Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt-Credit.

As so amended this portion of the text of the Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

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411.3 [Revoked]

Special Instructions — Accounts 411.4 and 411.5

A. Account 411.4 shall be debited with the amounts of investment tax credits related to electric utility property that are credited to account 255, Accumulated Deferred Investment Tax Credits, by companies which do not apply the entire amount of the benefits of the investment credit as a reduction of the overall income tax expense in the year in which such credit is realized (see account 255).

B. Account 411.4 shall be credited with the amounts debited to account 255 for proportionate amounts of tax credit deferrals allocated over the average useful life of electric utility property to which the tax credits relate or such lesser period of time as may be adopted and consistently followed by the company.

C. Account 411.5 shall also be debited and credited as directed in paragraphs A and B, for investment tax credits related to nonutility property.

411.4 Investment tax credit adjustments, utility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Utility Operations (by department).

411.5 Investment tax credit adjustments, nonutility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Non-utility Operations.

• • • • • 2. Other Income and Deductions • • • • •

420 Investment tax credits.

• • • • •
(a) By amounts equal to debits to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations, for investment tax credits used in calculating income taxes for the year when the company's accounting provides for nondeferral of all or a portion of such credits; and,

(b) • • •

421 Miscellaneous nonoperating income.

• • • • •
Items

• • • • •
3. Gains on disposition of investments. Also, gains on reacquisition and resale or retirement of utilities debt securities when the gain is not amortized and used by a jurisdictional regulatory agency to reduce embedded debt cost in establishing rates. See General Instruction 15.

426 [Revoked]

Special Instructions — Accounts 426.1, 426.2, 426.3, 426.4 and 426.5

These accounts shall include the miscellaneous expense items which are nonoperating in nature but which are properly deductible before determining total income before interest charges.

Note: The classification of expenses as nonoperating and their inclusion in these accounts is for accounting purposes. It does not preclude Commission consideration of proof to the contrary for ratemaking or other purposes.

• • • • • 426.5 Other deductions • • • • •

Items

• • • • •
3. Loss on reacquisition, resale or retirement of utility's debt securities, when the loss is not amortized and used by a jurisdictional regulatory agency to increase embedded debt cost in establishing rates. See General Instruction 15.

• • • • • 3. Interest Charges • • • • •

428 Amortization of debt discount and expense.

A. • • • Amounts charged to this account shall be credited concurrently to accounts 181, Unamortized Debt Expense, and 226, Unamortized Discount on Long-Term Debt-Debit.

• • • • • 428.1 Amortization of loss on reacquired debt.

A. This account shall include the amortization of the losses on reacquisition of debt. Amounts charged to this account shall be credited concurrently to account 189, Unamortized Loss on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the loss amortized applicable to each class

and series of long-term debt reacquired. See General Instruction 15.

429 Amortization of premium on debt-Credit.

A. . . . Amounts credited to this account shall be charged concurrently to account 225, Unamortized Premium on Long-Term Debt.

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429.1 Amortization of gain on reacquired debt-Credit.

A. This account shall include the amortization of the gains realized from reacquisition of debt. Amounts credited to this account shall be charged concurrently to account 257, Unamortized Gain on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the gains amortized applicable to each class and series of long-term debt reacquired. See General Instruction 15.

(6.) Revise the Operation and Maintenance Expense Accounts by deleting the words "Discount and" from Note B of account "928, Regulatory Commission Expenses." As revised, Note B of account 928 reads:

928 Regulatory commission expenses.

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Note B: Do not include in this account amounts includible in account 302, Franchises and Consents, account 181, Unamortized Debt Expense, or account 214, Capital Stock Expense.

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(E.) The Commission's Uniform System of Accounts for Class A and Class B Natural Gas Companies prescribed by Part 201, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1.) The General Instructions are amended:

(a) In instruction "2. *Records.*" paragraph "E" is amended by deleting Account "426, Miscellaneous Income Deductions," and substituting Account 426.5, Other Deductions, therefor.

(b) In instruction "7. *Extraordinary Items.*" the text is amended by amending the first sentence.

(c) Immediately following instruction "16. *Significance of Commission Opinions No. 568 and 568A on Accounting.*" a new instruction "17. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*" is added.

As so amended these portions of the General Instructions read as follows:

GENERAL INSTRUCTIONS

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2. *Records.*

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E. All amounts included in the accounts prescribed herein for gas plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.

7. *Extraordinary Items.* It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. . . .

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17. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

A. *Premium, discount and expense* — A separate premium, discount and expense account shall be maintained for each class and series of long-term debt (including receivers' certificates) issued or assumed by the utility. The premium will be recorded in account 225, Unamortized Premium on Long-Term Debt, the discount will be recorded in account 226, Unamortized Discount on Long-Term Debt — Debit, and the expense of issuance shall be recorded in account 181, Unamortized Debt Expense.

The premium, discount and expense shall be amortized over the life of the respective issues under a plan which will distribute the amounts equitably over the life of the securities. The amortization shall be on a monthly basis, and amounts thereof relating to discount and expense shall be charged to account 428, Amortization of Debt Discount and Expense. The amounts relating to premium shall be credited to account 429, Amortization of Premium on Debt — Credit.

B. *Reacquisition, without refunding* — When long-term debt is reacquired or redeemed without being converted into another form of long-term debt and when the transaction is not in connection with a refunding operation (primarily redemptions for sinking fund purposes), the difference between the amount paid upon reacquisition and the face value; plus any unamortized premium less any related unamortized debt expense and reacquisition costs; or less any unamortized discount, related debt expense and reacquisition costs applicable to the debt redeemed, retired and canceled, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility shall

amortize the recorded amounts equally on a monthly basis over the remaining life of the respective security issues (old original debt). The amounts so amortized shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt — Credit, as appropriate.

C. *Reacquisition, with refunding* — When the redemption of one issue or series of bonds or other long-term obligations is financed by another issue or series before the maturity date of the first issue, the difference between the amount paid upon refunding and the face value; plus any unamortized premium less related debt expense or less any unamortized discount and related debt expense, applicable to the debt refunded, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility may elect to account for such amounts as follows:

- (1) Write them off immediately when the amounts are insignificant.
- (2) Amortize them by equal monthly amounts over the remainder of the original life of the issue retired, or
- (3) Amortize them by equal monthly amounts over the life of the new issue.

Once an election is made, it shall be applied on a consistent basis. The amounts in (1), (2) or (3) above shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt — Credit, as appropriate.

D. Under methods (2) and (3) above, the increase or reduction in current income taxes resulting from the reacquisition should be apportioned over the remainder of the original life of the issue retired or over the life of the new issue, as appropriate, as directed more specifically in paragraphs E and F below.

E. When the utility recognizes the loss in the year of reacquisition as a tax deduction, account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited and account 283, Accumulated Deferred Income Taxes — Other, shall be credited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 283.

F. When the utility chooses to recognize the gain in the year of reacquisition as a taxable gain, account 411.1, Provision for Deferred Income Taxes — Credit, Utility Operating Income, shall be credited and account 190, Accumulated Deferred Income Taxes, shall be debited with the account of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 190.

G. When the utility chooses to use the optional privilege of deferring the tax on the gain attributable to the reacquisition of debt by reducing the depreciable basis of utility property for tax purposes, pursuant to Section 108 of the Internal Revenue Code, the related tax effects shall be deferred as the income is recognized for accounting purposes, and the deferred amounts shall be amortized over the life of the associated property on a vintage year basis. Account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited, and account 283, Accumulated Deferred Income Taxes — Other, shall be credited with

an amount equal to the estimated income tax effect applicable to the portion of the income, attributable to reacquired debt, recognized for accounting purposes during the period. Account 283 shall be debited and account 411.1, Provision for Deferred Income Taxes — Credit, Utility Operating Income, shall be credited with an amount equal to the estimated income tax effects, during the life of the property, attributable to the reduction in the depreciable basis for tax purposes.

H. The tax effects relating to gain or loss shall be allocated as above to utility operations except in cases where a portion of the debt reacquired is directly applicable to nonutility operations. In that event, the related portion of the tax effects shall be allocated to nonutility operations. Where it can be established that reacquired debt is generally applicable to both utility and nonutility operations, the tax effects shall be allocated between utility and nonutility operations based on the ratio of net investment in utility plant to net investment in nonutility plant.

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 419.1, Allowance of Funds Used During Construction.

J. *Alternate method* — Where a regulatory authority or a group of regulatory authorities having prime rate jurisdiction over the utility specifically disallows the rate principle of amortizing gains or losses on reacquisition of long-term debt without refunding, and does not apply the gain or loss to reduce interest charges in computing the allowed rate of return for rate purposes, then the following alternate method may

be used to account for gains or losses relating to reacquisition of long-term debt, with or without refunding.

(1) The difference between the amount paid upon reacquisition of any long-term debt and the face value, adjusted for unamortized discount, expenses or premium, as the case may be, applicable to the debt redeemed shall be recognized currently in income and recorded in account 421, Miscellaneous Nonoperating Income, or account 426.5, Other Deductions.

(2) When this alternate method of accounting is used, the utility shall include a footnote to each financial statement, prepared for public use, explaining why this method is being used along with the treatment given for ratemaking purposes.

(2.) The Chart of Balance Sheet Accounts is amended:

(a) By revising account title "181, Unamortized Debt Discount and Expense," to read "181, Unamortized Debt Expense."

(b) Immediately following account "188, Research and Development Expenditures," add new account 189, Unamortized Loss on Reacquired Debt.

(c) Immediately following account "224, Other Long-Term Debt," add two new accounts titled, 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt-Debit.

(d) By revoking account "251, Unamortized Premium on Debt."

(e) Immediately following account title "256, Deferred Gains from Disposition of Utility Plant," add account title 257, Unamortized Gain on Reacquired Debt.

As so amended, those portions of the Chart of Balance Sheet Accounts read:

BALANCE SHEET ACCOUNTS

(Chart of Account)

ASSETS AND OTHER DEBITS

• • • • •

4. Deferred Debits

181 Unamortized debt expense.

• • • • •

189 Unamortized loss on reacquired debt.

• • • • •

LIABILITIES AND OTHER CREDITS

• • • • •

6. Long-Term Debt

• • • • •

225 Unamortized premium on long-term debt.

226 Unamortized discount on long-term debt — Debit.

• • • • •

8. Deferred Credits

251 [Revoked]

• • • • •

257 Unamortized gain on reacquired debt.

(3.) The balance sheet accounts are amended:

(a) Revise account title and text of account "181, Unamortized Debt Discount and Expense." As revised, account 181 reads:

181 Unamortized debt expense.

This account shall include expenses related to the issuance or assumption of debt securities. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, and the amounts thereof shall be charged to account 428, Amortization of Debt Discount and Expense. Any unamortized amounts outstanding at the time that the related debt is prematurely reacquired shall be accounted for as indicated in General Instruction 17.

(b) Immediately following account "188, Research and Development Expenditures," add a new account titled 189, Unamortized Loss on Reacquired Debt, to read as follows:

189 Unamortized loss on reacquired debt.

This account shall include the losses on long-term debt reacquired or redeemed. The amounts in this account shall be amortized in accordance with General Instruction 17.

(c) Revise paragraph B of account "222, Reacquired Bonds." As revised, this portion of account 222 reads:

222 Reacquired bonds.

A. . . .

B. When bonds are reacquired, the difference between face value, adjusted for unamortized discount, expenses or premium, and the amount paid upon reacquisition, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. (See General Instruction 17.)

(d) Immediately following account "224, Other Long-Term Debt" add new accounts titled 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt — Debit, to read as follows:

225 Unamortized premium on long-term debt.

A. This account shall include the excess of the cash value of consideration received over the face value upon the issuance or assumption of long-term debt securities.

B. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, with the amounts thereof to be credited to account 429, Amortization of Premium on Debt-Credit. (See General Instruction 17.)

226 Unamortized discount on long-term debt — Debit.

A. This account shall include the excess of the face value of long-term debt securities over the cash value of consideration received therefor, related to the issue or assumption of all types and classes of debt.

B. Amounts recorded in this account shall be amortized over the life of the respective issues under a plan which will distribute the amount equitably over the life of the securities. The amortization shall be on a monthly basis, with the amounts thereof charged to account 428, Amortization of Debt Discount and Expense. (See General Instruction 17.)

(e) Revoke account "251, Unamortized Premium on Debt."

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate references to account 411.3, Investment Tax Credit Adjustments, and substitute therefore references to account "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations." As amended, account 255 reads:

255 Accumulated deferred investment tax credits.

A. This account shall be credited and account 411.4, Investment Tax Credit Adjustments, Utility Operations, or 411.5, Investment Tax Credit Adjustments, Nonutility Operations, as appropriate, shall be debited with investment tax credits deferred by companies which do not apply such credits as a reduction of the overall income tax expense in the year in which a tax credit is realized. There can be neither changes in accounting method for gas utility operations nor transfers from this account, except as authorized herein or as may otherwise be authorized by the Commission. (See the special instructions for accounts 411.4 and 411.5.)

B. This account shall be debited and account 411.4 or 411.5, as appropriate, shall be credited with a proportionate amount determined in relation to the average useful life of gas utility or nonutility property to which the tax credits relate, or such lesser period of time as may be adopted and consistently followed by the company.

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(g) Immediately following account "256, Deferred Gains from Disposition of Utility Plant," add a new account 257, Unamortized Gain on Reacquired Debt. As so amended, this portion of the balance sheet accounts reads:

257 Unamortized gain on reacquired debt.

This account shall include the amounts of discount realized upon reacquisition or redemption of long-term debt. The amounts in this account shall be amortized in accordance with General Instruction 17.

(4.) The Chart of Income Accounts are amended as follows:

(a) Immediately following account "411.1, Income Taxes Deferred in Prior Years — Credit, Utility Operating Income," revoke account title "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "425, Miscellaneous Amortization," revoke account title "426, Miscellaneous Income Deductions."

(c) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(d) Immediately following account "429, Amortization of Premium on Debt — Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt — Credit.

As so amended the Chart of Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

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Operating Expenses

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411.3 [Revoked]

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B. Other Income Deductions

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426 [Revoked]

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3. Interest Charges

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428.1 Amortization of loss on reacquired debt.

• • • • •

429.1 Amortization of gain on reacquired debt — Credit.

• • • • •

(5.) The text of the Income Accounts are amended and revised as follows:

(a) Revoke account "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "411.2, Provision for Deferred Income Taxes — Credit, Other Income and Deductions," add *Special Instructions — Accounts 411.4 and 411.5*, with text.

(c) Revise the text of accounts "411.4. Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

(d) Amend subparagraph (a) of account "420, Investment Tax Credits," by deleting the reference to account "411.3, Investment Tax Credit Adjustments," and substituting therefor a reference to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations.

(e) In account "421, Miscellaneous Nonoperating Income," amend item 3 by a phrase to the end of the item.

(f) Revoke account "426, Miscellaneous Income Deductions."

(g) Immediately following account "425, Miscellaneous Amortization," add *Special Instructions — Accounts 426.1, 426.2, 426.3, 426.4 and 426.5* with text.

(h) In account "426.5, Other Deductions," amend item "3."

(i) In account "428, Amortization of Debt Discount and Expense," revise the last sentence of paragraph A.

(j) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(k) In account "429, Amortization of Premium on Debt — Credit," revise the last sentence of paragraph A.

(l) Immediately following account "429, Amortization of Premium on Debt — Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt — Credit.

As so amended this portion of the text of the Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

• • • • •

411.3 [Revoked]

*Special Instructions**Accounts 411.4 and 411.5*

A. Account 411.4 shall be debited with the amounts of investment tax credits related to gas utility property that are credited to account 255, Accumulated Deferred Investment Tax Credits, by companies which do not apply the entire amount of the benefits of the investment credit as a reduction of the overall income tax expense in the year in which such credit is realized (see account 255).

B. Account 411.4 shall be credited with the amounts debited to account 255 for proportionate amounts of tax credit deferrals allocated over the average useful life of gas utility property to which the tax credits relate or such lesser period of time as may be adopted and consistently followed by the company.

C. Account 411.5 shall also be debited and credited as directed in paragraphs A and B, for investment tax credits related to nonutility property.

411.4 Investment tax credit adjustments, utility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Utility Operations (by department).

411.5 Investment tax credit adjustments, nonutility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Nonutility Operations.

• • • • •

2. Other Income and Deductions

• • • • •

420 Investment tax credits.

• • • • •

(a) By amounts equal to debits to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations, for investment tax credits used in calculating income taxes for the year when the company's accounting provides for nondeferral of all or a portion of such credits; and,

(b) • • •

421 Miscellaneous nonoperating income.

• • • • •

Items

• • • • •

3. Gains on disposition of investments. Also, gains on reacquisition and resale or retirement of utilities debt securities when the gain is not amortized and used by a jurisdictional regulatory agency to reduce embedded debt cost in establishing rates. See General Instruction 17.

• • • • •

426 [Revoked]

*Special Instructions**Accounts 426.1, 426.2, 426.3, 426.4 and 426.5*

These accounts shall include miscellaneous expense items which are nonoperating in nature but which are

properly deductible before determining total income before interest charges.

Note: The classification of expenses as nonoperating and their inclusion in these accounts is for accounting purposes. It does not preclude Commission consideration of proof to the contrary for ratemaking or other purposes.

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426.5 Other deductions

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Items

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3. Loss on reacquisition, resale or retirement of utility's debt securities, when the loss is not amortized and used by a jurisdictional regulatory agency to increase embedded debt cost in establishing rates. See General Instruction 17.

.
3. Interest Charges

.

428 Amortization of debt discount and expense.

A. . . . Amounts charged to this account shall be credited concurrently to accounts 181 Unamortized Debt Expense, and 226, Unamortized Discount on Long-Term Debt — Debit.

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428.1 Amortization of loss on reacquired debt.

A. This account shall include the amortization of the losses on reacquisition of debt. Amounts charged to this account shall be credited concurrently to account 189, Unamortized Loss on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the loss amortized applicable to each class and series of long-term debt reacquired. See General Instruction 17.

429 Amortization of premium on debt — Credit.

A. . . . Amounts credited to this account shall be charged concurrently to account 225, Unamortized Premium on Long-Term Debt.

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429.1 Amortization of gain on reacquired debt — Credit.

A. This account shall include the amortization of the gains realized from reacquisition of debt. Amounts credited to this account shall be charged concurrently to account 257, Unamortized Gain on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the gains amortized applicable to each class and series of long-term debt reacquired. See General Instruction 17.

(6.) Revise the Operation and Maintenance Expense Accounts by deleting the words "Discount and" from Note B of account "928, Regulatory Commission Expenses." As revised, Note B of account 928 reads:

928 Regulatory commission expenses.

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Note B: Do not include in this account amounts includible in account 302, Franchises and Consents, account 181, Unamortized Debt Expense, or account 214, Capital Stock Expense.

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(F.) The Commission's Uniform System of Accounts for Class C and Class D Natural Gas Companies prescribed by Part 204, Chapter I, Title 18 of the Code of Federal Regulations is amended as follows:

(1.) The General Instructions are amended:

(a) In instruction "2. *Records.*" paragraph "E" is amended by deleting Account "426, Miscellaneous Income Deductions," and substituting Account 426.5, Other Deductions, therefor.

(b) In instruction "8. *Extraordinary Items.*" the text is amended by amending the first sentence.

(c) Immediately following instruction "14. *Gas Well Records.*" a new instruction "15. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*" is added.

As so amended these portions of the General Instructions read as follows:

GENERAL INSTRUCTIONS

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2. *Records.*

.

E. All amounts included in the accounts prescribed herein for gas plant and operating expenses shall be just and reasonable and any payments or accruals by the utility in excess of just and reasonable charges shall be included in account 426.5, Other Deductions.

8. *Extraordinary Items.* It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described in paragraph 9 and long-term debt as described in paragraph 15 below. . . .

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15. *Long-Term Debt: Premium, Discount and Expense, and Gain or Loss on Reacquisition.*

A. *Premium, discount and expense* — A separate premium, discount, and expense account shall be maintained for each class and series of long-term debt (including receivers' certificates) issued or assumed by the utility. The premium will be recorded in account 225, Unamortized Premium on Long-Term Debt, the discount will be recorded in account 226, Unamortized Discount on Long-Term Debt — Debit, and the expense of issuance shall be recorded in account 181, Unamortized Debt Expense.

The premium, discount and expense shall be amortized over the life of the respective issues under a plan which will distribute the amounts equitably over the life of the securities. The amortization shall be on a monthly basis, and amounts thereof relating to discount and expense shall be charged to account 428, Amortization of Debt Discount and Expense. The amounts relating to premium shall be credited to account 429, Amortization of Premium on Debt — Credit.

B. *Reacquisition, without refunding* — When long-term debt is reacquired or redeemed without being converted into another form of long-term debt and when the transaction is not in connection with a refunding operation (primarily redemptions for sinking fund purposes), the difference between the amount paid upon reacquisition and the face value; plus any unamortized premium less any related unamortized debt expense and reacquisition costs; or less any unamortized discount, related debt expense and reacquisition costs applicable to the debt redeemed, retired and canceled,

shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 258, Unamortized Gain on Reacquired Debt, as appropriate. The utility shall amortize the recorded amounts equally on a monthly basis over the remaining life of the respective security issues (old original debt). The amounts so amortized shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt — Credit, as appropriate.

C. *Reacquisition, with refunding* — When the redemption of one issue or series of bonds or other long-term obligations is financed by another issue or series before the maturity date of the first issue, the difference between the amount paid upon refunding and the face value; plus any unamortized premium less related debt expense or less any unamortized discount and related debt expense, applicable to the debt refunded, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. The utility may elect to account for such amounts as follows:

(1) Write them off immediately when the amounts are insignificant.

(2) Amortize them by equal monthly amounts over the remainder of the original life of the issue retired, or

(3) Amortize them by equal monthly amounts over the life of the new issue.

Once an election is made, it shall be applied on a consistent basis. The amounts in (1), (2) or (3) above

shall be charged to account 428.1, Amortization of Loss on Reacquired Debt, or credited to account 429.1, Amortization of Gain on Reacquired Debt — Credit, as appropriate.

D. Under methods (2) and (3) above, the increase or reduction in current income taxes resulting from the reacquisition should be apportioned over the remainder of the original life of the issue retired or over the life of the new issue, as appropriate, as directed more specifically in paragraphs E and F below.

E. When the utility recognizes the loss in the year of reacquisition as a tax deduction, account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited and account 283, Accumulated Deferred Income Taxes — Other, shall be credited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 283.

F. When the utility chooses to recognize the gain in the year of reacquisition as a taxable gain, account 411.1, Provision for Deferred Income Taxes — Credit, Utility Operating Income, shall be credited and account 190, Accumulated Deferred Income Taxes, shall be debited with the amount of the related tax effect, such amount to be allocated to the periods affected in accordance with the provisions of account 190.

G. When the utility chooses to use the optional privilege of deferring the tax on the gain attributable to the reacquisition of debt by reducing the depreciable basis of utility property for tax purposes, pursuant to Section 108 of the Internal Revenue Code, the related tax effects shall be deferred as the income is recognized for accounting purposes, and the deferred

amounts shall be amortized over the life of the associated property on a vintage year basis. Account 410.1, Provision for Deferred Income Taxes, Utility Operating Income, shall be debited, and account 283, Accumulated Deferred Income Taxes — Other, shall be credited with an amount equal to the estimated income tax effect applicable to the portion of the income, attributable to reacquired debt, recognized for accounting purposes during the period. Account 283 shall be debited and account 411.1, Provision for Deferred Income Taxes — Credit, Utility Operating Income, shall be credited with an amount equal to the estimated income tax effects, during the life of the property, attributable to the reduction in the depreciable basis for tax purposes.

H. The tax effects relating to gain or loss shall be allocated as above to utility operations except in cases where a portion of the debt reacquired is directly applicable to nonutility operations. In that event, the related portion of the tax effects shall be allocated to nonutility operations. Where it can be established that reacquired debt is generally applicable to both utility and nonutility operations, the tax effects shall be allocated between utility and nonutility operations based on the ratio of net investment in utility plant to net investment in nonutility plant.

I. Premium, discount, or expense on debt shall not be included as an element in the cost of construction or acquisition of property (tangible or intangible), except under the provisions of account 419.1, Allowance for Funds Used During Construction.

J. *Alternate method* — Where a regulatory authority or a group of regulatory authorities having prime rate jurisdiction over the utility specifically disallows

the rate principle of amortizing gains or losses on reacquisition of long-term debt without refunding, and does not apply the gain or loss to reduce interest charges in computing the allowed rate of return for rate purposes, then the following alternate method may be used to account for gains or losses relating to reacquisition of long-term debt, with or without refunding.

(1) The difference between the amount paid upon reacquisition of any long-term debt and the face value, adjusted for unamortized discount, expenses or premium, as the case may be, applicable to the debt redeemed shall be recognized currently in income and recorded in account 421, Miscellaneous Nonoperating Income, or account 426.5, Other Deductions.

(2) When this alternate method of accounting is used, the utility shall include a footnote to each financial statement, prepared for public use, explaining why this method is being used along with the treatment given for ratemaking purposes.

(2.) The Chart of Balance Sheet Accounts is amended:

(a) By revising account title "181, Unamortized Debt Discount and Expense," to read "181, Unamortized Debt Expense."

(b) Immediately following account "187, Deferred Losses from Disposition of Utility Plant," add new account 189, Unamortized Loss on Reacquired Debt.

(c) Immediately following account "224, Other Long-Term Debt," add two new accounts titled, 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt — Debit.

(d) By revoking account "251, Unamortized Premium on Debt."

(e) Immediately following account title "256, Deferred Gains from Disposition of Utility Plant," add account title 257, Unamortized Gain on Reacquired Debt.

As so amended, those portions of the Chart of Balance Sheet Accounts read:

BALANCE SHEET ACCOUNTS

(Chart of Accounts)

ASSETS AND OTHER DEBITS

• • • • •

4. Deferred Debits

181 Unamortized debt expense.

• • • • •

189 Unamortized loss on reacquired debt.

• • • • •

LIABILITIES AND OTHER CREDITS

• • • • •

6. Long-Term Debt

• • • • •

225 Unamortized premium on long-term debt.

226 Unamortized discount on long-term debt — Debit.

• • • • •

8. Deferred Credits

251 [Revoked]

• • • • •

257 Unamortized gain on reacquired debt.

(3.) The balance sheet accounts are amended:

(a) Revise account title and text of account "181, Unamortized Debt Discount and Expense." As revised, account 181 reads:

181 Unamortized debt expense.

This account shall include expenses related to the issuance or assumption of debt securities. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, and the amounts thereof shall be charged to account 428, Amortization of Debt Discount and Expense. Any unamortized amounts outstanding at the time that the related debt is prematurely reacquired shall be accounted for as indicated in General Instruction 15.

(b) Immediately following account "188, Research and Development Expenditures," add a new account titled 189, Unamortized Loss on Reacquired Debt, to read as follows:

189 Unamortized loss on reacquired debt.

This account shall include the losses on long-term debt reacquired or redeemed. The amounts in this account shall be amortized in accordance with General Instruction 15.

(c) Revise paragraph B of account "221, Bonds." As revised, this portion of account 221 reads:

221 Bonds.

A. • • •

B. When bonds are reacquired, the difference between face value, adjusted for unamortized discount,

expenses or premium, and the amount paid upon reacquisition, shall be included in account 189, Unamortized Loss on Reacquired Debt, or account 257, Unamortized Gain on Reacquired Debt, as appropriate. (See General Instruction 15.)

(d) Immediately following account "224, Other Long-Term Debt," add new accounts titled 225, Unamortized Premium on Long-Term Debt, and 226, Unamortized Discount on Long-Term Debt — Debit, to read as follows:

225 Unamortized premium on long-term debt.

A. This account shall include the excess of the cash value of consideration received over the face value upon the issuance or assumption of long-term debt securities.

B. Amounts recorded in this account shall be amortized over the life of each respective issue under a plan which will distribute the amount equitably over the life of the security. The amortization shall be on a monthly basis, with the amounts thereof to be credited to account 429, Amortization of Premium on Debt — Credit. (See General Instruction 15.)

226 Unamortized discount on long-term debt — Debit.

A. This account shall include the excess of the face value of long-term debt securities over the cash value of consideration received therefor, related to the issue or assumption of all types and classes of debt.

B. Amounts recorded in this account shall be amortized over the life of the respective issues under a plan which will distribute the amount equitably over the life of the securities. The amortization shall be on a monthly basis, with the amounts thereof charged to

account 428, Amortization of Debt Discount and Expense. (See General Instruction 15.)

(e) Revoke account "251, Unamortized Premium on Debt."

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate references to account 411.3, Investment Tax Credit Adjustments, and substitute therefor references to account "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations." As amended, account 255 reads:

255 Accumulated deferred investment tax credits.

A. This account shall be credited and account 411.4, Investment Tax Credit Adjustments, Utility Operations, or 411.5, Investment Tax Credit Adjustments, Nonutility Operations, as appropriate, shall be debited with investment tax credits deferred by companies which do not apply such credits as a reduction of the overall income tax expense in the year in which a tax credit is realized. There can be neither changes in accounting method for gas utility operations nor transfers from this account, except as authorized herein or as may otherwise be authorized by the Commission. (See the special instructions for accounts 411.4 and 411.5.)

B. This account shall be debited and account 411.4 or 411.5, as appropriate, shall be credited with a proportionate amount determined in relation to the average useful life of gas utility or nonutility property to which the tax credits relate, or such lesser period of time as may be adopted and consistently followed by the company.

• • • • •

(g) Immediately following account "256, Deferred Gains from Disposition of Utility Plant," add a new account 257, Unamortized Gain on Reacquired Debt. As so amended, this portion of the balance sheet accounts reads:

257 Unamortized gain on reacquired debt.

This account shall include the amounts of discount realized upon reacquisition or redemption of long-term debt. The amounts in this account shall be amortized in accordance with General Instruction 15.

(4) The Chart of Income Accounts are amended as follows:

(a) Immediately following account "411.1, Income Taxes Deferred in Prior Years — Credit, Utility Operating Income," revoke account title "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "425, Miscellaneous Amortization," revoke account title "426, Miscellaneous Income Deductions."

(c) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(d) Immediately following account "429, Amortization of Premium on Debt — Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt — Credit.

As so amended the Chart of Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

• • • • •

Operating Expenses

• • • • •

411.3 [Revoked]

• • • • •

B. Other Income Deductions

• • • • •

426 [Revoked]

• • • • •

3. Interest Charges

• • • • •

428.1 Amortization of loss on reacquired debt.

• • • • •

429.1 Amortization of gain on reacquired debt — Credit.

• • • • •

(5.) The text of the Income Accounts are amended and revised as follows:

(a) Revoke account "411.3, Investment Tax Credit Adjustments."

(b) Immediately following account "411.2, Provision for Deferred Income Taxes — Credit, Other Income and Deductions," add *Special Instructions — Accounts 411.4 and 411.5*, with text.

(c) Revise the text of accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

(d) Amend subparagraph (a) of account "420, Investment Tax Credits," by deleting the reference to account "411.3, Investment Tax Credit Adjustments," and substituting therefor a reference to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations.

(e) In account "421, Miscellaneous Nonoperating Income," amend item 3 by a phrase to the end of the item.

(f) Revoke account "426, Miscellaneous Income Deductions."

(g) Immediately following account "425, Miscellaneous Amortization," add *Special Instructions — Accounts 426.1, 426.2, 426.3, 426.4 and 426.5* with text.

(h) In account "426.5, Other Deductions," amend item "3."

(i) In account "428, Amortization of Debt Discount and Expense," revise the last sentence of paragraph A.

(j) Immediately following account "428, Amortization of Debt Discount and Expense," add a new account 428.1, Amortization of Loss on Reacquired Debt.

(k) In account "429, Amortization of Premium on Debt — Credit," revise the last sentence of paragraph A.

(l) Immediately following account "429, Amortization of Premium on Debt — Credit," add a new account 429.1, Amortization of Gain on Reacquired Debt — Credit.

As so amended this portion of the text of the Income Accounts reads:

INCOME ACCOUNTS

1. Utility Operating Income

• • • • •

411.3 [Revoked]

Special Instructions

Accounts 411.4 and 411.5

A. Account 411.4 shall be debited with the amounts of investment tax credits related to gas utility property that are credited to account 255, Accumulated Deferred Investment Tax Credits, by companies which do not apply the entire amount of the benefits of the investment credit as a reduction of the overall income tax expense in the year in which such credit is realized (see account 255).

B. Account 411.4 shall be credited with the amounts debited to account 255 for proportionate amounts of tax credit deferrals allocated over the average useful life of gas utility property to which the tax credits relate or such lesser period of time as may be adopted and consistently followed by the company.

C. Account 411.5 shall also be debited and credited as directed in paragraphs A and B, for investment tax credits related to nonutility property.

411.4 Investment tax credit adjustments, utility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Utility Operations (by department).

411.5 Investment tax credit adjustments, nonutility operations.

This account shall include the amount of those investment tax credit adjustments related to property used in Nonutility Operations.

.

2. Other Income and Deductions

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420 Investment tax credits.

.

(a) By amounts equal to debits to accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, and 411.5, Investment Tax Credit Adjustments, Nonutility Operations, for investment tax credits used in calculating income taxes for the years when the company's accounting provides for nondeferral of all or a portion of such credits; and,

(b)

421 Miscellaneous nonoperating income.

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Items

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3. Gains on disposition of investments. Also, gains on reacquisition and resale or retirement of utilities debt securities when the gain is not amortized and used by a jurisdictional regulatory agency to reduce embedded debt cost in establishing rates. See General Instruction 15.

.

426 [Revoked]

Special Instructions

Accounts 426.1, 426.2, 426.3, 426.4 and 426.5

These accounts shall include miscellaneous expense items which are nonoperating in nature but which are properly deductible before determining total income before interest charges.

Note: The classification of expenses as nonoperating and their inclusion in these accounts is for accounting purposes. It does not preclude Commission consideration of proof to the contrary for ratemaking or other purposes.

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426.5 Other deductions

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Items

.

3. Loss on reacquisition, resale or retirement of utility's debt securities, when the loss is not amortized and used by a jurisdictional regulatory agency to increase embedded debt cost in establishing rates. See General Instruction 15.

.

3. Interest Charges

.

428 Amortization of debt discount and expense.

A. Amounts charged to this account shall be credited concurrently to accounts 181, Unamortized Debt Expense, and 226, Unamortized Discount on Long-Term Debt — Debit.

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428.1 Amortization of loss on reacquired debt.

A. This account shall include the amortization of the losses on reacquisition of debt. Amounts charged to this account shall be credited concurrently to account 189, Unamortized Loss on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the loss amortized applicable to each class and series of long-term debt reacquired. See General Instruction 15.

429 Amortization of premium on debt — Credit.

A. . . . Amounts credited to this account shall be charged concurrently to account 225, Unamortized Premium on Long-Term Debt.

.

429.1 Amortization of gain on reacquired debt — Credit.

A. This account shall include the amortization of the gains realized from reacquisition of debt. Amounts credited to this account shall be charged concurrently to account 257, Unamortized Gain on Reacquired Debt.

B. This account shall be maintained so as to allow ready identification of the gains amortized applicable to each class and series of long-term debt reacquired. See General Instruction 15.

(6.) Revise the Operation and Maintenance Expense Accounts by deleting the words "Discount and" from Note B of Account "928, Regulatory Commission Expenses." As revised, Note B of account 928 reads:

928 Regulatory commission expenses.

.

Note B: Do not include in this account amounts includible in account 302, Franchises and Consents,

account 181, Unamortized Debt Expense, or account 214, Capital Stock Expense.

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(G.) Subparagraph (d) of Section 141.1, Part 141, Subchapter D, Chapter I, Title 18 CFR, is amended by adding a schedule titled, Unamortized Loss and Gain on Reacquired Debt, immediately following schedule "Deferred Losses from Disposition of Utility Plant." As so amended, the subparagraph reads:

§141.1 Form No. 1, Annual report for electric utilities, licensees and others (Class A and Class B).

.

(d) This annual report contains the following schedules:

.

Unamortized Loss and Gain on Reacquired Debt

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(H.) Subparagraph (c) of Section 260.1, Part 260, Subchapter G, Chapter I, Title 18 CFR, is amended by adding a schedule titled, Unamortized Loss and Gain on Reacquired Debt, immediately following schedule "Deferred Losses from Disposition of Utility Plant." As so amended, the subparagraph will read:

§260.1 Form No. 2, Annual report for natural gas companies (Class A and Class B).

.

(c) This annual report contains the following schedules:

.

Unamortized Loss and Gain on Reacquired Debt.

(I.) Schedule pages 110 and 111, Comparative Balance Sheet, 112, Notes to Balance Sheet, and 116A, Statement of Income for the Year, in FPC Form No. 1, Annual Report for Public Utilities, Licensees and Others (Class A and Class B), prescribed by § 141.1, Chapter I, Title 18 of the Code of Federal Regulations are amended as set forth in Attachments B and D hereto.

(J.) Schedule pages 110 and 111, Comparative Balance Sheet, 112, Notes to Balance Sheet, and 116A, Statement of Income for the Year, in FPC Form No. 2, Annual Report for Natural Gas Companies (Class A and Class B), prescribed by § 260.1, Chapter I, Title 18 of the Code of Federal Regulations are amended as set forth in Attachments C and D hereto.

(K.) Schedule pages 211, Unamortized Debt Discount and Expense and Unamortized Premium on Debt (Accounts 181 and 251), 220, Securities Issued or Assumed and Securities Refunded or Retired During the Year, 304, Particulars Concerning Certain Income Deduction and Interest Charges Accounts, and 305, Expenditures for Certain Civic, Political and Related Activities (Subaccount 426.4), in FPC Form No. 1, Annual Report for Public Utilities and Licensees and Others (Class A and Class B), prescribed by § 141.1, Chapter I, Title 18 of the Code of Federal Regulations and FPC Form No. 2, Annual Report for Natural Gas Companies (Class A and Class B), prescribed by § 260.1, Chapter I, Title 18 of the Code of Federal Regulations are revised as set forth in Attachment D hereto.

(L.) Schedule page 214B, Unamortized Loss and Gain on Reacquired Debt (Accounts 189, 257), is added to FPC Form No. 1, Annual Report for Public Utilities, Licensees and Others (Class A and Class B) prescribed in § 141.1, Chapter I, Title 18 of the Code of Federal Regulations and FPC Form No. 2, Annual Report for Natural Gas Com-

panies (Class A and Class B) prescribed in § 260.1, Chapter I, Title 18 of the Code of Federal Regulations, as set forth in Attachment E hereto.

(M.) Schedule pages 3, Comparative Balance Sheet, and 6, Statement of Income for the Year, in FPC Form No. 1-F, Annual Report for Public Utilities and Licensees (Class C and Class D) prescribed by § 141.2, Chapter I, Title 18 of the Code of Federal Regulations are amended as set out in Attachments F and H hereto.

(N.) Schedule pages 3, Comparative Balance Sheet and 6, Statement of Income for the Year, in FPC Form No. 2-A, Annual Report of Natural Gas Companies, prescribed by § 260.2, Chapter I, Title 18 of the Code of Federal Regulations are amended as set out in Attachments G and H hereto.

(O.) Schedule page 2, Balance Sheet in FPC Form No. 1-M, Annual Report for Municipal Electric Utilities Having Annual Electric Operating Revenues of \$250,000 or More, prescribed by § 141.7, Chapter I, Title 18 of the Code of Federal Regulations, as set out in Attachment I hereto.

(P.) FPC Form No. 5, Monthly Statement of Electric Operating Revenue and Income, prescribed by § 141.25, Chapter I, Title 18 of the Code of Federal Regulations is amended as set out in Attachment J hereto.

(Q.) FPC Form No. 11, Natural Gas Pipeline Company Monthly Statement, prescribed by § 260.3, Chapter I, Title 18 of the Code of Federal Regulations is amended as set out in Attachment K hereto.

(R.) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission. Commissioner Moody, dissenting, filed a separate statement appended hereto.

Kenneth F. Plumb,
Secretary.

Accounting for Premium, Discount
and Expense of Issue, Gains and
Losses on Refunding and Reacqui-
sition of Long-Term Debt, and Inter-
period Allocation of Income Taxes

Docket No. R- 424

(Issued February 11, 1974)

MOODY, Commissioner, *dissenting*:

I would prefer bringing the treatment of gains and losses on reacquisition of long-term debt into harmony with our recent decision to treat gains and losses on non-utility property as "below the line" items (see Order No. 473, issued February 15, 1973); such a decision would obviate any necessity for deciding between current accounting and amortized accounting, but more importantly, such a decision would bring about a correct balance between ratepayer and stockholder interests in the handling of non-utility property.

In any event, the comments filed persuade me that gains and losses on reacquisition of long-term debt should be accounted for currently in accordance with Opinion No. 26 of the Accounting Principles Board, issued October, 1972, and in accordance with Commission practice over the past thirty years. I find no substantial evidence supporting the change imposed by the majority.

RUSH MOODY, JR.

Rush Moody, Jr., Commissioner

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR Parts 101, 104, 201 and 204]

Accounting for Premium, Discount
and Expense of Issue, Gains and
Losses on Refunding, and Reacqui-
sition of Long-Term Debt, and Inter-
period Allocation of Income Taxes.

Docket No. R-424

Erratum Notice

(May 29, 1974)

Order No. 505

(Issued February 11, 1974)

Page 19:

Revoke ordering subparagraph (C.)(3.)(f) and substi-
tute the following new subparagraph therefor:

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate reference to account 411.3, Investment Tax Credit Adjustments and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Nonutility Operations." As amended account 255 reads:

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have elected to follow deferral accounting, partial or full, rather than recognizing in the income statement the total benefits of the tax credit as realized. After such election, a company may not transfer amounts from this account, except as authorized herein and in

accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, 411.5, Investment Tax Credit Adjustments, Nonutility Operations, and 420, Investment Tax Credits, or with approval of the Commission.

B. Where the company's accounting provides that investment tax credits are to be passed on to customers, this account shall be debited and account 411.4 credited with a proportionate amount determined in relation to the average useful life of electric utility property to which the tax credits relate or such lesser period of time as allowed by a regulatory agency having rate jurisdiction. If, however, the deferral procedure provides that investment tax credits are not to be passed on to customers, the proportionate restorations to income shall be credited to account 420.

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Page 39:

Revoke ordering subparagraph (D.)(3.)(f) and substi-
tute the following new subparagraph therefor:

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate reference to account 411.3, Investment Tax Credit Adjustments and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations." As amended account 255 reads:

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have elected to follow deferral accounting, partial or full, rather than recognizing in the income statement the total

benefits of the tax credit as realized. After such election, a company may not transfer amounts from this account, except as authorized herein and in accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, 411.5, Investment Tax Credit Adjustments, Nonutility Operations, and 420, Investment Tax Credits, or with approval of the Commission.

B. Where the company's accounting provides that investment tax credits are to be passed on to customers, this account shall be debited and account 411.4 credited with a proportionate amount determined in relation to the average useful life of electric utility property to which the tax credits relate or such lesser period of time as allowed by a regulatory agency having rate jurisdiction. If, however, the deferral procedure provides that investment tax credits are not to be passed on to customers, the proportionate restorations to income shall be credited to account 420.

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Page 60:

Revoke ordering subparagraph (E.)(3.)(f) and substitute the following new subparagraph therefor:

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate reference to account "411.3, Investment Tax Credit Adjustments," and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have

elected to follow deferral accounting, partial or full, rather than recognizing in the income statement the total benefits of the tax credit as realized. After such election, a company may not transfer amounts from this account, except as authorized herein and in accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, 411.5, Investment Tax Credit Adjustments, Nonutility Operations, and 420, Investment Tax Credits, or with approval of the Commission.

B. Where the company's accounting provides that investment tax credits are to be passed on to customers this account shall be debited and account 411.4 credited with a proportionate amount determined in relation to the average useful life of gas utility property to which the tax credits relate or such lesser period of time as allowed by a regulatory agency having rate jurisdiction. If, however, the deferral procedure provides that investment tax credits are not to be passed on to customers, the proportionate restorations to income shall be credited to account 420.

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Page 81:

Revoke ordering subparagraph (F.)(3.)(f) and substitute the following new subparagraph therefor:

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate reference to account "411.3, Investment Tax Credit Adjustments," and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have elected to follow deferral accounting, partial or full, rather than recognizing in the income statement the total benefits of the tax credits as realized. After such election, a

PART 204 — UNIFORM SYSTEM OF ACCOUNTS FOR
NATURAL GAS COMPANIES (CLASS C
AND CLASS D)

Revoke ordering subparagraph (F.)(3.)(f) (page 6105) and substitute the following subparagraph therefor:

(f) Amend paragraphs "A" and "B" of account "255, Accumulated Deferred Investment Tax Credits," to eliminate reference to account "411.3, Investment Tax Credit Adjustments," and substitute therefor reference to accounts "411.4, Investment Tax Credit Adjustments, Utility Operations," and "411.5, Investment Tax Credit Adjustments, Nonutility Operations."

255 Accumulated deferred investment tax credits.

A. This account shall be credited with all investment tax credits deferred by companies which have elected to follow deferral accounting, partial or full, rather than recognizing in the income statement the total benefits of the tax credit as realized. After such election, a company may not transfer amounts from this account, except as authorized herein and in accounts 411.4, Investment Tax Credit Adjustments, Utility Operations, 411.5, Investment Tax Credit Adjustments, Nonutility Operations, and 420, Investment Tax Credits, or with approval of the Commission.

B. Where the company's accounting provides that investment tax credits are to be passed on to customers,

this account shall be debited and account 411.4 credited with a proportionate amount determined in relation to the average useful life of gas utility property to which the tax credits relate or such lesser period of time as allowed by a regulatory agency having rate jurisdiction. If, however, the deferral procedure provides that investment tax credits are not to be passed on to customers, the proportionate restorations to income shall be credited to account 420.

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Kenneth F. Plumb,
Secretary.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR Parts 101, 104, §§141.1, 141.2, 141.7
Parts 201, 204, §§260.1, 260.2]

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Rush Moody,
Jr., William L. Springer, and Don
S. Smith.

Accounting for Premium, Discount
and Expense of Issue, Gains and
Losses on Refunding, and Reacqui-
sition of Long-Term Debt, and
Interperiod Allocation of Income
Taxes

Docket No. R-424

ORDER NO. 505-A

Supplemental Order Amending Order Implementing
That Portion of Docket No. R-424 Relating to Account-
ing for Premium, Discount and Expense of Issue, Gains
and Losses on Refunding and Reacquisition of Long-
Term Debt.

(Issued February 25, 1974)

On February 11, 1974, the Commission issued Order No. 505 in this proceeding. By that order the Commission found that good cause existed for making the amendments to the Uniform Systems of Accounting for Public Utilities and Licensees and Natural Gas Companies ordered therein to be effective January 1, 1973, and the amendments to FPC Annual Report Forms No. 1, No. 1-F, No. 1-M, No. 2 and No. 2-A effective for the reporting year 1973. The effective date of amendments to FPC Forms No. 5 and No. 11 was effective upon issuance of the order.

Due to the fact that some companies have rendered Annual Stockholder Reports to the public for the accounting

year 1973, prior to receipt of Order No. 505, it is deemed practical to allow the implementation date of the accounting prescribed in Order No. 505 to be effective January 1, 1974. And further, due to the fact that the FPC Annual Report Forms No. 1, No. 1-F, No. 2 and No. 2-A are already in the hands of respondents for the reporting year 1973 it is deemed practical to allow those companies who elect to implement the provisions of Order No. 505, January 1, 1974, to report their 1973 accounting data in a modified fashion on the new prescribed report changes for 1973 as described below:

FPC Annual Report Form No. 1

Schedule page 110:

Line 34 — Report the Debt Expense portion of old account 181 here with the Unamortized Debt Discount portion of old account 181 being reported at line 18 on schedule page 111.

Line 42 — Make no entry.

Schedule page 111:

Line 17 — Report balance of old account 251 here.

Line 36 — Make no entry.

Schedule page 116A:

Lines 50 and 52 — Make no entry.

Schedule page 211:

Report appropriate detail from old accounts 181 and 251.

Schedule page 214B:

Make no entry.

FPC Annual Report Form No. 2

Schedule page 110:

Line 31 — Report the Debt Expense portion of old account 181 here with the Unamortized Debt Discount portion of old account 181 being reported at line 18 on schedule page 111.

Line 39 — Make no entry.

Schedule pages 116A, 211 and 214B:

Same as for Form No. 1 above.

FPC Annual Report Form No. 1-F

Schedule page 3:

Line 19, column (a) — Report the Debt Expense portion of old account 181 here with the Unamortized Debt Discount portion of old account 181 being reported at column (e), line 16.

Line 24, column (a) — Make no entry.

Line 15, column (e) — Enter balance of old account 251.

Line 31, column (e) — Make no entry.

Schedule page 6:

Lines 48 and 50 — Make no entry.

FPC Annual Report Form No. 2-A

Schedule page 3:

Line 21, column (a) — Report the Debt Expense portion of old account 181 here with the Unamortized Debt Discount portion of old account 181 being reported at line 16.

Line 26, column (a) — Make no entry.

Line 15, column (e) — Enter balance of old account 251.

Line 32, column (e) — Make no entry.

Schedule page 6:

Lines 48 and 50 — Make no entry.

The Commission Finds:

(1) The notice and opportunity to participate in this proceeding with respect to the matters presently before this Commission through the submission, in writing, of data, views, comments and suggestions in the manner as described above are consistent and in accordance with all procedural requirements therefor as prescribed in Section 553 of Title 5 of the United States Code.

(2) The effective date of amendments to the Commission's Uniform System of Accounts and Annual Report Form schedules herein prescribed are necessary and appropriate for the administration of the Federal Power Act and Natural Gas Act.

(3) The amendments prescribed herein which were not included in the notice in this proceeding are of a minor nature, and further notice thereof is therefore unnecessary.

The Commission, acting pursuant to the provisions of the Federal Power Act, as amended, particularly Sections 301, 302, 303, 304 and 309 thereof (49 Stat. 854-856, 859; 16 U.S.C. 825, 825a, 825b, 825c, 825h) and Natural Gas Act, as amended, particularly Sections 8, 9, 10 and 16 thereof (52 Stat. 825, 826, 830; 15 U.S.C. 717g, 717h, 717i, 717o),
orders:

That the provisions of Order No. 505 issued by the Commission February 11, 1974, may be implemented as of Jan-

uary 1, 1974, and that where implemented January 1, 1974, a modified method of reporting will be used as prescribed heretofore in this order.

By the Commission.

(S E A L)

Kenneth F. Plumb
Secretary.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: John N. Nassikas, Chairman;
Albert B. Brooke, Jr., Rush
Moody, Jr., William L. Springer,
and Don S. Smith

Accounting for Premium, Discount
and Expense of Issue, Gains and
Losses on Refunding and Reacqui-
sition of Long-Term Debt, and Inter-
period Allocation of Income Taxes.

Docket No. R-424

ORDER DENYING REHEARING AND
RECONSIDERATION

(Issued June 3, 1974)

In its Order No. 505¹ issued on February 11, 1974, the Commission prescribed accounting for (1) premium, discount and expense of long-term debt, (2) gains and losses on reacquired long-term debt, when no refunding is involved, and (3) gains and losses on reacquisition of long-term debt when a refunding is involved. Briefly stated, the new accounting regulations provide that when no refunding is involved, as in (2), the utility shall amortize the net gain or loss over the remaining life of the respective security issues (old, original debt). When, as in (3), the redemption of one issue or series of long-term debt securities is financed by another issue or series, the net gains or losses from reacquisition of the original debt securities, the utility may elect to account for such amounts by either: (i) writing them off immediately if amounts are insignificant; (ii) amortizing them over the life of the original issue which is

¹ Order No. 505, 51 F.P.C. (39 F. R. 6093, February 19, 1974).

being retired; or (iii) amortizing them over the life of the new issue. Where a regulatory authority which has prime rate jurisdiction over the utility disallows the rate principle of amortizing gains or losses on reacquisition of long-term debt without refunding and does not apply such amounts in computing rate of return allowed, an alternate method may be used, recognizing such amounts currently in income and using explanatory footnotes in financial statements.

On March 13, 1974, Interstate Natural Gas Association of America (INGAA) filed an application for rehearing of Order No. 505. Texas Eastern Transmission Corporation, (Texas Eastern) on the same date filed an Application for Rehearing concurring in and adopting the INGAA application.

INGAA's application urges the Commission to reconsider its action and to rescind its Order No. 505 and terminate these proceedings, contending, in summary, that:

Order No. 505 is legally improper, without substantial evidentiary support and is directly contrary to long established Commission policy and sound accounting principles as prescribed by the Accounting Principles Board (APB) of the American Institute of Certified Public Accountants. Further, at a time when the pipeline industry is faced with growing difficulties in obtaining money for important projects the Commission blithely takes action which will artificially reduce current net income of many companies thereby reducing their ability to finance much needed endeavors to enhance supply...

Upon a review of these contentions, as more fully set forth in INGAA's application, we find no basis for changing or modifying our order. We indicated in Order No. 505 the legal basis and evidentiary background for the rulemaking

order prescribing accounting changes in this proceeding in Docket No. R-424:

... We established a rate making principle in Opinion No. 583, *Manufacturers Light and Heat Co.* ... (44 FPC 314) that gains and losses relating to reacquisition of long-term debt should be amortized over the remaining life of the old debt and to deduct the amortization amount from the actual charges for interest to determine the *true embedded cost of debt*. Failure to provide accounting recognition of this significant rate-making policy would result in distortions of financial statements. (emphasis added)

In Opinion No. 583, in *Manufacturers*, we stated:

24. Secondly, the discounts on repurchased debt under consideration here represent a savings which is virtually automatic ... Unless amortization of these amounts is required, the cumulative effect will be to add large sums to retained earnings, with no benefit to consumers. Yet consumers will continue to pay the cost of debt, including new debt issued at higher rates to replace that retired.

.

... We are cognizant that current accounting practice is to credit gains from retirement of debt securities to income in the year such securities are repurchased and retired. However, since it is acceptable accounting practice to amortize redemption premiums over the remaining lives of refunded bonds² and since in future rate proceedings redemption premiums are to be included in the embedded cost of debt, we believe

² Accounting Research Bulletin 43, Chapter 15, Unamortized Discount, Issue Cost, and Redemption Premium on Bonds Refunded.

that the same accounting policy should be adopted toward gains from repurchase and retirement. This will bring accounting and ratemaking into conformity and the income will be available for future rate consideration. Such accounting and ratemaking purposes is sanctioned by the accounting profession because they recognize that there are and will be instances where regulatory authorities differ from other commercial accounting practices.³

INGAA's application contends that the Commission "blithely" ignored the fact that the result of the changed accounting would affect the "current" net income of many companies and would thereby reduce their ability to finance new facilities needed to enhance their dwindling gas supplies. That this is erroneous is obvious in view of the fact that in Opinion No. 583 we gave full consideration to Manufacturer's financial needs in determining its rate of return, while at the same time indicating that these gains and losses should be amortized and the benefits shared with the consumer.

INGAA's argument ignores the fact that the prescribed amortization does *not* reduce net income, as an accounting matter. Although "current" net income may be reduced in one year, the order merely spreads such income (and losses) over ten or more years of the remaining lives of the particular security issues involved. Moreover, although Opinion No. 583 requires the benefits to be shared with consumers by reflecting in rates and charges the current year's amortization of such discounts and premiums, it also allows the companies the interim cost-free use of the

³ Addendum (Accounting Principles for Regulated Industries) to Opinion No. 2 of the Accounting Principles Board, accounting for the "investment credit".

excess of current net gains, or losses, over such level of amortized income currently reflected in rates and charges.

INGAA's application objects to the Commission's expressed intent to bring ratemaking and accounting into a closer area of conformity and to avoid apparent distortion of financial statements. In support of its contention, INGAA cites recent rulemaking orders of the Commission and asserts that the Commission therein did not follow such "tracking symmetry".⁴ Where applicable, the Commission's accounting regulations are designed, primarily, to aid it in the surveillance of costs of service of jurisdictional companies for the purpose of ratemaking, licensing and the corollary protection of the investing public. Under various circumstances, accounting treatment and ratemaking treatment must necessarily diverge, but we do not believe that this is one of them.

INGAA's contention that Order No. 505 is without evidentiary support and is invalid, likewise, is erroneous. The Commission issued its accounting regulations for natural gas companies in the exercise of its authority under Sections 8, 9, 10 and 16 of the Natural Gas Act. In *Manufacturers*, as well as in this proceeding, the Commission afforded all interested parties notice and an opportunity to present their views and contentions.⁵ No party has pre-

⁴ Order No. 469, Docket No. R-395, (49 FPC 326), [dealing with Equity Method of Accounting;] Order No. 504, Docket No. R-446, dealing with Interperiod Tax Allocation, issued February 11, 1974; Order No. 440-A, Docket No. R-403 (47 FPC 39), Full-Cost Accounting for Exploration and Development Costs of Pipeline Companies.

⁵ INGAA erroneously asserts the Commission gave no notice it was considering adoption of an industry-wide principle of accounting. See notice issued October 31, 1969, published in Federal Register on November 1, 1969, (43 F.R. 17743), following which 7 pipeline companies, a major city, a national accounting firm and INGAA filed *amicus* briefs in *Manufacturers* (44 FPC 314, 321).

sented any allegation of factual data and material which raise any issues which would require cross-examination or further evidentiary hearings. INGAA's application fails to raise any such issue. With respect to INGAA's position on the financial impact of the order, this is a rate of return question which, as we have stated above, is properly considered in rate making on a single-company basis. Indeed, although INGAA requests that a "formal hearing" be provided for submission of testimony, it fails to allege any facts or to make a proffer of anything of substance which such testimony would show. We, therefore, conclude that to provide any such "evidentiary" hearing would be without justification and would merely delay the determinations of the Commission and the necessary implementation of the order which has been found to be required in the interests of fairness to the consumer, the investor and the public interest.

INGAA urges that the new regulations are contrary to long established Commission policy and sound accounting principles announced by the Accounting Principles Board (APB), now the Financial Accounting Standards Board (FASB), of the American Institute of Certified Public Accountants for commercial accounting guidance. However, as we observed in Opinion No. 583, in view of regulatory policies, regulatory accounting may properly differ from commercial accounting practices, as even the APB recognizes. The Commission's authority and responsibility for accounting derives from the Federal Power Act (Section 301) and from the Natural Gas Act (Section 8), not

The Commission modified its accounting order therein in response to such presentations. (44 FPC 1138). In this proceeding, we issued a Notice of Proposed Rulemaking on August 6, 1971 (36 F.R. 16069), amended October 13, 1971 (36 F.R. 20445). Comments were received from 67 respondents, of whom 62 addressed themselves to the long-term debt issues (Attachment A to Order No. 505).

from such commercial and professional bodies, although the announcements of such bodies are considered to be of substantial significance and the pertinent accounting principles have been carefully compared with the new regulations. With respect to the change in our own policy and treatment of these gains and losses, it is sufficient to state that we gave very careful consideration to that question in Opinion No. 583, and we have reviewed the accounting reflection of the ratemaking policy in this rulemaking proceeding, as stated above.

Docket No. R-424

The Commission finds:

Interstate Natural Gas Association of America and Texas Eastern Transmission Corporation's applications for rehearing filed March 13, 1974, present no new facts or points of law which were not considered in Order No. 505, or which, having now been considered, warrant any change or modification of that order, and their applications, therefore, should be denied.

The Commission orders:

The applications filed on March 13, 1974, by INGAA and Texas Eastern for rehearing of Order No. 505, are denied.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

(Issued June 3, 1974)

BROOKE, Commissioner, *dissenting:*

Further review of the accounting treatment proposed in Docket No. R-424, based on responses to Order No. 505,

have persuaded me that the regulation should not be adopted. I concur in Commissioner Moody's dissenting comments to the instant order.

ALBERT B. BROOKE, JR.
Albert B. Brooke, Jr.
Commissioner

(Issued June 3, 1974)

MOODY, Commissioner, *dissenting*:

Order No. 505 does not purport to reach its result on the basis of evidence adduced through the rulemaking process; rather its attempts to translate the *ad hoc* rate determinations of Opinion 583, 44 FPC 314, issued August 17, 1970, in Docket No. RP69-16, *Manufacturer's Heat and Light Co.*, into an accounting rule of general applicability. The motions for rehearing correctly identify the legal error implicit in so proceeding.

I dissented to Order No. 505. I dissent here again, still persuaded that we act without evidentiary support, without regard to generally accepted accounting principles and without regard to the financial impact of our accounting change. The majority must surely recognize that the result of Order No. 505 is to reduce reported per share earnings; at a time when the financing requirements of the utility industry are of such magnitude as to cause serious concern, the Commission does a grave disservice to the public interest by making financing more difficult.

RUSH MOODY, JR.
Rush Moody, Jr., Commissioner

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1781

TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner,

v.

FEDERAL POWER COMMISSION,
Respondent.

No. 74-1784

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Petitioner.

v.

FEDERAL POWER COMMISSION,
Respondent.

Before:

Mr. Justice Clark*, Wright and MacKinnon,
Circuit Judges.

ORDER

It is ORDERED by the court, *sua sponte*, that on or before June 23, 1975 respondent file in the record answers to the following questions:

1. Will Order No. 505 itself tend to affect rates and/or rate-making in some circumstances?
2. If so, in what circumstances and how?

It is FURTHER ORDERED by the court that on or before June 30, 1975 the parties file memoranda containing any comment they wish to make on respondent's answers to the above questions.

Per Curiam For the Court
Hugh E. Kline, Clerk

* Of the Supreme Court of the United States, Retired, sitting by designation pursuant to 23 U.S.C. § 294(a) (1970).

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1781

TEXAS EASTERN TRANSMISSION CORPORATION,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent.

No. 74-1784

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,

Petitioner,

v.

FEDERAL POWER COMMISSION,

Respondent.

Before:

Mr. Justice Clark*, Wright and MacKinnon,
Circuit Judges

ORDER

IT IS ORDERED by the Court that the record in these cases is remanded to the Federal Power Commission for further proceedings consistent with the attached memorandum.

Per Curiam

* Of the Supreme Court of the United States, Retired, sitting by designation pursuant to 23 U.S.C. § 294(a) (1970).

No. 74-1781 — *Texas Eastern Transmission Corporation v. Federal Power Commission*

No. 74-1784 — *Interstate Natural Gas Association of America v. Federal Power Commission*

MEMORANDUM

We are loathe to reverse the Federal Power Commission's judgment in the somewhat arcane area of accounting regulations for public utilities, especially when we are uncertain about the confusion which a reversal might create. Yet we would be abdicating our judicial function were we to affirm on the basis of the materials before us. The Commission order under attack in this case provides only the most conclusory justifications for the challenged rule, and the Commission's later efforts have offered little more. We have therefore determined to remand this proceeding to the FPC with instructions to prepare a new opinion if the Commission continues to adhere to the regulation contested in this appeal. This memorandum is intended to explain the sources of our current dissatisfaction with the Commission's explanations. Our hope is that any new opinion will be sufficiently informative to allow us finally to determine the validity of the Commission's order.

I. The Commission's Reasoning

In Order No. 505, the Commission's explanation of the reason for requiring utilities' financial reports to amortize gains and losses on repurchase of debt was terse:

... we believe that the accounting and financial statements of a regulated utility should reflect the economic effects of rates. ... We established a rate principle in Opinion No. 583, Manufacturer's Light and Heat Company, RP69-16, issued August 17, 1970 (44 FPC 314) that gains and losses relating to reacquisition of long-

term debt should be amortized over the remaining life of the old debt and to deduct the amortization amount from the actual charges for interest to determine the true embedded cost of debt. Failure to provide accounting recognition of this significant ratemaking policy would result in distortion of financial statements.

Joint Appendix (JA) 118. On the basis of this statement, the Commission formally found the proposed regulations "necessary and appropriate for the administration of" the Federal Power and Natural Gas Acts. JA 120-121. In its order denying rehearing, the Commission reiterated the above statement and explained the rationale for amortizing repurchase gains in ratemaking, a matter not at issue. The only additional reasoning adduced in support of its decision was the following statement:

Where applicable, the Commission's accounting regulations are designed, primarily, to aid it in the surveillance (sic) of costs of service of jurisdictional companies for the purpose of ratemaking, licensing and the corollary protection of the investing public. Under various circumstances, accounting treatment and ratemaking treatment must necessarily diverge, but we do not believe that this is one of them.

JA 190. The Commission also disputed the contention that its new rule would have a harmful effect on the utilities' ability to raise capital and indicated that any such impact was relevant only to the ratemaking proceeding. JA 191.

In all, the Commission seems to have suggested, at one point or another in this litigation, five separable but related rationales for its action: 1) amortization in financial statements is necessary to preserve the ratemaking principle of the *Manufacturers* opinion; 2) the accounting rule aids in surveillance of public utility rates; 3) without this accounting rule, utilities' financial statements would be distorted

because accounting would not reflect the economic impact of ratemaking; 4) there is no reason to deviate from the Commission's policy of using the same procedure for accounting and for ratemaking; and, 5) any harm resulting from the accounting rule is minimal. With the possible exception of the claim that the accounting rule is necessary to preserve the ratemaking principle, each of these propositions may be found in the original decision or the order denying a rehearing.

II. Evaluation of the Commission's Reasoning

We begin with the proposition that rules issued by the Commission must be "necessary or appropriate" to the administration of the Commission's regulatory functions. 15 U.S.C. §§ 717g, 717f, 717o; 16 U.S.C. §§ 825, 825c, 825h. The Commission's authority to issue rules "merely augment[s] existing powers conferred upon the agency by Congress, [it does] not confer independent authority to act." *New England Power Co. v. FPC*, 151 U.S. App. D.C. 371, 376-377, 467 F.2d 425, 430-431 (D.C. Cir. 1972), *aff'd*, 415 U.S. 345 (1974) (footnote omitted); *Texaco, Inc. v. FPC*, 154 U.S. App. D.C. 168, 172, 474 F.2d 416, 420 (D.C. Cir. 1972), *vacated on other grounds*, 417 U.S. 380 (1974). Accounting rules must be "designed to meet the informational needs of effective regulation and the public needs of economical rates . . ." *Democratic Central Comm. v. Washington Metropolitan Area Transit Comm'n.*, 158 U.S. App. D.C. 7, 41 n. 316, 485 F.2d 786, 820 n. 316 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974). The Commission may also act to assure that the public reports of companies it regulates do not mislead the investing public. *Appalachian Power Co. v. FPC*, 328 F.2d 237, 246-252 (4th Cir.), *cert. denied*, 379 U.S. 329 (1964).

Since the issuance of an accounting regulation is an informal rulemaking, our only concern is whether the Commission has proceeded arbitrarily and capriciously in its choice of means with which to achieve permissible ends. We require only a "statement of basis and purpose", 5 U.S.C. § 553(c), which sets forth a rational relationship among the record, the Commission's purposes and the regulation adopted. We will not substitute our judgment for the Commission's, but we must require that it demonstrate "a rational connection between the facts found and the choice made," *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962), and that its decision be sufficiently clear that its "path may reasonably be discerned." *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 236 (1974). We examine the FPC's proffered explanations in light of this standard.

A. *Need for the accounting rule to preserve the rate-making principle* — The order denying rehearing quotes a portion of the decision in the *Manufacturers* ratemaking case in which the accounting rule eventually adopted in Order No. 505 was said to make "the income . . . available for future rate consideration." JA 189. This rationale, which was not adverted to in Order No. 505 or in any other portion of the order denying rehearing, was most fully developed by the Commission's counsel during oral argument before this court. During that argument, counsel maintained that the accounting rule is necessary to prevent the companies from paying dividends out of their savings from bond repurchases. We were told that if such dividends were paid, the funds would not be available for rate adjustment and the ratemaking principle of *Manufacturers* would be destroyed. See also Br. for FPC at 23 ("Also, consumers are protected by the added assurance that these amounts are properly reserved as future offsets to cost of capital.")

Were this reasoning sustainable, it would obviously be useful to justify the accounting regulation. In response to a question propounded by the court, however, the Commission backed away from the claim made during oral argument. The Commission stated in its memorandum of June 23, 1975 that "[i]n summary, Order No. 505 generally has no effect upon rates and/or rate-making." Thus, the Commission no longer seeks to have us affirm its order as necessary to the preservation of the *Manufacturers* rate-making principle. We therefore do not have to determine whether this rationale is an impermissible "post hoc rationalization" of appellate counsel.

In order to guide the Commission should it wish to return to this defense of its regulation, we consider its appropriate to note some questions which this contention raises. The essential premise appears to be that if the utility does not maintain an amortization reserve account, it will not be possible (or will at least be more difficult) for the FPC to apply an allowance for repurchase savings against the cost of embedded debt in a ratemaking proceeding. In other words, the argument envisions a distinct sum of money, resulting from repurchase savings, which is not fungible with the company's other funds and which must be used either for corporate purposes or for reducing the cost of debt. While this view has a surface plausibility, we require at least some explanation of why it is the correct view. This explanation should deal with the apparent lack of direct relationship between the embedded cost of debt and the allowed rate of return. See *Manufacturers Light & Heat Co.*, 44 FPC 314, 328 (1970) ("The process of determining the overall rate of return neither lends itself to a precise mathematical determination nor should it. Patently, a determination involves consideration of the cost of embedded debt and the cost of equity, as well as a number of factors which vary from company to company

... Further, some factors are necessarily judgments.") In light of the Commission's own experience in the *Manufacturers* case and of the comments of the New York State PSC, JA 36-37, the Commission must also explain why its accounting rule is "necessary or appropriate" in aid of ratemaking. We must be shown that the Commission has some reason for rejecting normalization and any other possible alternative procedures.

B. *Need for the accounting rule to maintain surveillance of public utility rates* — This point was originally made, by implication, in the order denying rehearing, *see* p. 2 *supra*. Although it was not relied on in the Commission's brief, the surveillance argument was one of two major points in the June 23 memorandum submitted in response to this court's order. In that memorandum, the Commission argues first that

Order No. 505 prescribes accounting which breaks down the gains realized in the reacquisition of long-term debt by amortizing them, because that is how rates are derived. That break-down allows better surveillance of a utility's earnings and better analysis of its actual rate of return. Consequently, if a utility is earning more than the allowable rate of return because of such gains, the financial statement will provide some indication of that fact.

June 23 Memorandum at 2-3. The Commission then points out the amortization will have also the converse effect of indicating that a rate reduction is not necessary despite a single year's large gain on repurchased debt. *Id.* at 3-4. "Therefore, the accounting methods of Order No. 505 reinforce the rate-making methods of Opinion No. 583 by illustrating the results of ratemaking and providing some indication of the necessity for or lack of necessity for rate adjustments." *Id.* at 4.

Although the "necessary or appropriate" standard gives the Commission a great deal of flexibility, we must be told more before we can conclude that the Commission has justified its accounting rule and not simply identified an incidental benefit of that rule. In view of the fact that petitioners' opposition to this rule is based on its assumed negative impact on reported earnings, we find it difficult to understand how the rule will help alert consumers to *excess* utility earnings. If there is any support for this proposition in the comments submitted to the Commission, appropriate references would be most helpful. If the primary impact of the rule is to prevent some observers from concluding incorrectly that a rate reduction is in order, the Commission must explain why quieting consumers is "necessary or appropriate" to administration of the Gas and Power Acts. Again, the Commission must at the least explain why it disagrees with the suggestion of the New York State PSC that the accounting rule is not necessary for the ratemaking procedures adopted in *Manufacturers*.

C. *Need for the accounting rule to avoid distortion in the utilities' financial statements* — In the form of a conclusory statement that failure to adopt the challenged accounting rule would create distortion, this rationale for the rule was relied on in both the Commission's order, *see* p. 2 *supra*, and the order denying rehearing. In its brief, the Commission explained the source of the distortion:

This distortion would result because the current accounting method would transfer amounts to retained earnings accounts while concealing the fact that those amounts would be amortized for rate-making purposes. Thus investors might rely upon retained earnings as an investment guide and could be misled into thinking that amounts were available as potential dividends. In reality, these amounts would merely represent funds to be used in a lesser rate calculation as an off-set to cost of capital. Simply put, investors would rely upon

amounts which were presently unavailable to investors and which might eventually be used to pay for capital.

Br. for FPC at 22. The Commission also claimed that its rule would make financial statements a more reliable guide for investment decisions by "smooth[ing] out the year-by-year fluctuations caused by changes of conditions in the money market." *Id.* at 23.

The claim that investors will rely on funds which are, in effect, already committed to consumers depends on the vision of repurchase savings as a distinct fund. The comments made previously about this premise apply here as well. *See pp. 6-7 supra.* In addition, since the Commission is here concerned with misleading investors — a concern properly within its range of interest but one outside its field of special expertise — it should explain why the reporting convention adopted by the accounting profession and generally utilized in financial statements is inadequate to protect investors in utilities. Although the Commission is correct that the decisions of the Accounting Principles Board cannot override the rulemaking powers granted by Congress, we believe that an explanation is required when the FPC overrides both its own past practice and the thoroughly deliberated conclusion of the professional group most concerned with the accuracy of financial statements. (Of course, if the Commission is able to explain its distinct fund conception, the misleading nature of a report which does not consider the use of that fund will be clear). Similarly, an explanation is required before the Commission's conclusion that smoothed-out earnings figures are more informative than the standard financial report can be accepted.

D. *Commission policy is to use the same procedure for ratemaking and accounting.* The Commission has relied

throughout this proceeding on the claim that its policy is to conform accounting for financial reporting purposes to the accounting techniques used for ratemaking purposes. In the absence of a validly adopted rule which requires such conformity, we fail to understand how a pattern of past practice can create an independent justification for a proposed rule. If the accounting change challenged here can be shown to be "necessary or appropriate" for administration of the Commission's responsibilities, the rule is valid. If such a showing cannot be made, the rule is invalid. In either case, the fact that the Commission has or has not found it "necessary or appropriate" to conform other reporting and ratemaking accounting procedures cannot foreclose the inquiry in this case.

E. *Any harm resulting from Order No. 505 is minimal* — Obviously, this argument cannot serve as an independent justification for a rule, and the Commission has not offered it as such a justification. But since we cannot uphold a rule under the "arbitrary and capricious" standard unless we are convinced that the Commission's "decision was based on a consideration of the relevant factors. . . .", *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 416 (1971), the Commission's decision must demonstrate that it has balanced the expected benefits of its rule against the harms foreseen in the comments which are part of the record. The Commission's original order contained no recognition of these comments, and the order denying rehearing, while appearing both to admit and to deny that there would be adverse impact on utilities' capital raising capacity, made no effort to compare benefits and costs. In its brief, the Commission attempted to minimize the impact of the regulation by relying on unsupported assertions concerning the source of investment money, Br. for FPC at 25-26, 29, and by suggesting that the lost capital raising

capacity is insignificant, *id.* at 26-30. Nowhere does the Commission explain why the costs incurred are outweighed by the rule's benefits.

Of course, if the Commission can demonstrate that failure to amortize would make the financial reports misleading the fact that an accurate report would allow a company to issue less debt than would an inaccurate report is inconsequential. *See Appalachian Power Co. v. FPC, supra*, 328 F.2d at 252. Similarly, if the Commission can explain how the accounting rule assists the Commission's efforts to carry out its assigned functions, balancing that assistance against the impact on the utilities' ability to raise capital should not be difficult. If the Commission can meet neither of these prerequisites, this rule should be withdrawn.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR Parts 101, 141, §§ 141.1, 141.2, 141.7
Parts 201, 204, §§ 260.1, 260.2]

Before Commissioners: Richard L. Dunham, Chairman;
Don S. Smith, and
John H. Holloman III

Accounting for Premium, Discount
and Expense of Issue, Gains and
Losses on Refunding, and Reacqui-
sition of Long-Term Debt, and
Interperiod Allocation of Income
Taxes

Docket No. R-424

ORDER NO 505-B

Supplemental Order Clarifying and Affirming Commis-
sion Order No. 505 Concerning That Portion of Docket
No. R-424 Relating to Accounting for Premium, Dis-
count and Expense of Issue Gains, and Losses on
Refunding and Reacquisition of Long-Term Debt.

(Issued July 8, 1977)

This rulemaking was instituted to promulgate the proper accounting for (1) premium, discount and expense of issue of long term debt; (2) gains and losses on reacquired debt, when no refunding is involved, and (3) gains and losses on reacquisition of long-term debt when a refunding is involved. The earlier orders in this docket have been remanded by the Circuit Court of Appeals for the District of Columbia with instructions "to prepare a new opinion if the Commission continues to adhere to the regulation contested in this appeal." *Texas Eastern Transmission Corporation v. FPC*, No. 74-1781 (D.C. Cir. Sept. 18, 1975), slip at 1. For the reasons stated herein, the Commission shall reaffirm its previous orders, concerning the proper accounting for these items.

Order No. 505, 51 FPC 714 (1974), and *Order No. 505-A*, 51 FPC 832 (1974), required jurisdictional utilities and natural gas companies to use accounting procedures which would track the Commission rate treatment for gains and losses for reacquired debt, first stated in *Manufacturers and Heat Company*, 44 FPC 314 (1970). The accounting procedures adopted in this rulemaking provide for, in cases where no refunding is involved amortization of the net gain or loss on an equal monthly basis over the remaining life of the respective security issues (i.e., the old original debt). Where refunding is involved and the redemption of one issue or series of long-term debt securities is financed by a new issue or series, the utility or natural gas company may elect to account for the net gain or loss from the reacquisition of the old original debt in one of three ways: (1) write off immediately the amounts if they are insignificant; (2) amortize the amounts on an equal monthly basis over the life of the old original debt being retired; or (3) amortize the amounts on an equal monthly basis over the life of the new issue. In those cases where the regulatory authority having primary jurisdiction over a utility or natural gas company does not follow the Commission's rate treatment for amortizing gains or losses on reacquisition of long-term debt, this rulemaking allows a utility to use an alternative accounting method under which these amounts would be recognized in the year of reacquisition as income. When this alternative method is used, it would be explained in footnotes to the utility or natural gas company's financial statements.

Relationship of Uniform Systems of Accounts to the Determination of Just and Reasonable Rates.

Section 301(a) of the Federal Power Act and Section 8(a) of the Natural Gas Act state in part that:

• • • • •

• • • The Commission may prescribe a system of accounts to be kept by licensees and public utilities (natural-gas companies) and may classify such licensees and public utilities (natural-gas companies) and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited. • • • (Emphasis added)

The Commission established the Uniform System of Accounts for Public Utilities and Licensees, 18 CFR, Parts 101 and 104 (1976), and the Uniform System of Accounts for Natural Gas Companies, 18 CFR, Parts 201 and 204 (1976), which apply to all utilities and natural gas companies under the Commission's jurisdiction. From the inception of these systems, the Commission has required that the system of accounts be used to support all tariff filings because consistently developed information provides a framework within which filings can be consistently evaluated. Use of a uniform system facilitates comparability which not only aids analysis in rate proceedings, but also assists the Commission in making accurate cost of service determinations and helps to assure that jurisdictional utilities will state plant, income, expense and various other accounts in a similar manner.

Consequently, the Commission evaluates the need for accounting changes when changes in ratemaking policies or procedures are considered, and considers the rate implications before making official changes to the systems of accounts. Various public interest factors, such as, effect on the consumer, benefit and convenience to the utilities, and assistance to the investor, are considered before any changes are made. This process allows the systems of

accounts to be structured in support of the ratemaking concepts with which they are interrelated.

The Commission generally maintains its Uniform Systems of Accounts in conformity with the standards announced by the Financial Accounting Standards Board (FASB)¹. However, in cases where there are material conflicts between FASB standards and rate making realities, the Uniform Systems of Accounts differ from such standards.

The fact that accounting for regulated industries may properly differ from the accounting for non-regulated industries was formally recognized by the Accounting Principles Board (APB), now FASB, in December 1962 with the issuance of its Opinion No. 2, which included this statement as an Addendum:

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2. However, differences may arise in the application of generally accepted accounting principles as between the regulated and nonregulated business, because of the effect in regulated business of the rate-making process, a phenomenon not present in nonregulated business. Such differences usually concern mainly the time at which various items enter into the determination of net income in accordance with the principle of matching costs and revenues. For example, if a cost incurred by a regulated business during a given period is treated for rate-making purposes by the regulatory authority having jurisdiction as applicable to future revenues, it may be deferred in the balance sheet at the end of the current period and written off in the future period or periods in which the related revenue accrues,

¹ Successor of this Accounting Principles Board (APB) of the American Institute of Certified Public Accountants. Pronouncements of the APB made and in effect prior to establishment of the FASB remain in effect unless subsequently modified by the FASB.

even though the cost is of a kind which in a nonregulated business would be written off currently. However, this is appropriate only when it is clear that the cost will be recoverable out of future revenues, and it is not appropriate when there is doubt, because of economic conditions or for other reasons, that the cost will be so recoverable.

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When APB issued Opinion No. 26, *Early Extinguishment of Debt* (Opinion of Accounting Principles Board, October 1972), it recognized the continuing validity and necessity of the principles of the Addendum in the matter before it.

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2. *Applicability.* . . . This Opinion applies to regulated companies in accordance with the provisions of the Addendum to APB Opinion No. 2, Accounting for the "Investment Credit," 1962.

The Addendum recognizes an economic reality, accounting and reporting principles cannot be the same in every instance for regulated and nonregulated business, which results from the rate making process under which regulated business must operate. The basic objective of the rate making process is to match costs and revenues. To achieve this objective, it is often necessary, as the Addendum notes, to spread costs during the entire period over which related revenues will be derived, rather than enter them entirely during the chronological time period in which they are incurred, as would be the practice in nonregulated business. Recognition of the differences between regulated and non-regulated business through differences in accounting and financial reporting reflects the economic results of the rate actions of the regulating body.

In matching revenues and expenses for rate purposes, the Commission has, in the past, provided in its Uniform

Systems of Accounts for amortization of costs and revenues to reflect the economic effect of the ratemaking process. Amortization of these costs and revenues by non-regulated companies would not be permitted under generally accepted accounting principles applicable to nonregulated industries. In establishing just and reasonable rates, it would not always be necessary for the Commission to provide accounting that tracks the ratemaking. However, accounting for an item of cost in a particular accounting period, in addition to matching revenues and expenses, provides the presumption that the cost or revenue will be similarly treated in future rate proceedings. Examples of these costs and revenues which are deferred and amortized are:

- (1) Extraordinary Property Losses²
- (2) Purchased Gas Costs³
- (3) Gains and Losses from the Sale of Property Held for Future Use⁴

In addition to the above examples, the Commission has provided alternate accounting, depending on the rate treatment, for the tax effect of the differences between book and tax return treatment of costs (tax allocation) in order to reflect the economics of the ratemaking process. If the Commission had adhered to generally accepted principles of accounting with respect to tax allocation without consideration of the rate aspect, the financial statements of many regulated companies would have been misleading to all but the most sophisticated readers.

In the instant situation, the Commission found that to match the costs and revenues applicable to long-term debt,

² Parts 101-304, 104-439, 201-153, 204-282.

³ Parts 201-155, 204-283.

⁴ Parts 101-305, 311; 104-438, 44; 201-154, 161; 204-203, 288.

it is necessary to include the costs or revenues derived from the reacquisition of debt. *Manufacturers Light and Heat Company*, 44 FPC 314 (1970). The Commission has consistently used the actual cost of long-term debt held by the utility in the overall rate of return determination. In *Manufacturers*, supra, the Commission held that the revenues⁵ related to reacquisition of debt represented a reduction of long-term debt costs, which should be passed on to the consumer.

Patently, all legitimate costs incurred in financing or refinancing debt are part of the cost of debt, and should be passed on to the consumer. Conversely, any reduction in or savings associated with cost of debt also should be passed on to the consumer. (44 FPC 323)

In a nonregulated business, savings from reacquisition of debt inure solely to the stockholders and there is no obligation to adjust prices to pass the savings or losses on to customers. Consistent therewith, accounting practices for nonregulated business call for the savings to be credited to income in the year received.⁶ However, such accounting is not consistent with the rate objective of *Manufacturers* which indicates that the savings are not to become windfall profits to the regulated company but should be passed on to the consumer by lowering debt costs reflected in rates. While the rate policy under *Manufacturers* could be followed regardless of the accounting, consistency between the accounting and ratemaking not only facilitates the rate-making process, but more importantly, is necessary to avoid

⁵ An economic situation in which interest rates for new debt are higher than those of the debt being retired insures that reacquisition of debt will be at a savings (and, thus, revenues) to the utility. Of course, if interest rates were lower than those of the reacquired debt, reacquisition would be achieved at a premium (that is, added cost) to the utility.

⁶ APB Opinion No. 26, Early Extinguishment of Debt (October 1975).

financial reporting that obscures the economic realities of the ratemaking process to the detriment of investors and others relying on the financial statements.

Interstate Natural Gas Association of America and Texas Eastern Transmission Company (Petitioners) submitted a Settlement Offer dated March 3, 1976, and a supplement to the Offer, dated September 3, 1976. The Offer proposes to settle the controversy in this matter by: (a) withdrawing the accounting regulations in Order Nos. 505 and 505-A which require deferral and amortization for accounting and financial reporting purposes of gains (losses) on reacquired securities; (b) permitting the accounting treatment with respect thereto in accordance with the Commission's policy prior to issuance of such Orders, in accordance with generally accepted accounting principles; and (c) utilization in rate proceedings of the information concerning gains and losses prescribed in Statement F(3)(g) of Section 154.63(e) (4) of the Commission's Regulations.

Petitioners assert that they do not object to disclosure but contend that the Statements required by Statement F(3)(g) fully satisfy the Commission's stated objectives.

What Petitioners have in effect proposed is that they be allowed to follow the accounting prescribed for nonregulated business concerns, which credits the gains or charges the losses from reacquisition of debt to current income in the year the reacquisition is made. Under their proposal, published financial statements would not disclose the true nature of the reported gains or losses in light of the Commission's ratemaking policy. Such deficiency cannot be overcome by the presence in the Commission's files of information provided in connection with a rate filing made months or even years prior to the issuance of financial statements. Even if the information in the public files of the

Commission happened to be current, we fail to see how the public interest would be served. We should not impose on the reader of published financial statements the burden of seeking out information in the Commission's individual rate docket files to finally discover that gains (losses) used in calculating reported current net income available to stockholders do not really belong to the stockholders, but instead are to be passed on to consumers in future years through the ratemaking process. The fact that the gains (losses) are not immediately flowed through to consumers, but are instead passed on over a number of years (through reductions or increases in the debt costs entering into rate of return determinations) does not justify reporting them as current gains (losses) for the account of the stockholders.

Petitioners claim that the accounting proposed by this rulemaking places

an undue and discriminatory burden on regulated utilities in competing for capital and artificially and unnecessarily limit(s) the amount of debt securities the regulated utility could issue under standard indenture restrictions thereby creating a situation whereby a utility may be forced to resort to higher cost equity financing.⁷

In support of this contention, Petitioners attached a one-page summary to the Supplement showing what they claim are the additional net income and additional indebtedness available under generally accepted accounting principles as opposed to what is available under this rulemaking. This summary shows that 11 of the largest gas pipeline companies would have had reported a total additional net income of \$29 million in 1974 and \$26 million in 1975. This summary shows also an increase in borrowing capacity in total for the 11 companies of \$106 million in 1974 and \$118 million in 1975.

⁷ Petitioners have not averred that this theoretical situation has, in fact, occurred.

We agree that our adherence to accounting for gains (losses) in a manner consistent with the economic realities of the ratemaking process lowers the total borrowing capacity of some companies and could conceivably cause a company to resort to equity financing. However, we note that, although our accounting rule was issued February 11, 1974, Petitioners have not shown or even alleged that the rule has, in fact, caused such a result. The fact that the effect of our rule on reported net income is significant lends support to our position that accounting and financial reporting needs to reflect the economic effects of the ratemaking processes.

The Commission is well aware of the critical needs of utilities for capital at a reasonable cost and, in recent years, has taken many actions to help utilities improve their financial viability. However, we cannot in good conscience attempt to meet such needs by permitting accounting and reporting which is inconsistent with the economic realities of the ratemaking process and, therefore, contrary to the interests of investors and others relying on published financial statements.

The Commission orders:

(A) The accounting procedures adopted originally in Order No. 505 are hereby affirmed.

(B) Petitioners' Requests for Settlement or vacation are hereby denied.

(C) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Secretary

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

[18 CFR Parts 101, 141, Sections 141.1, 141.2, 141.7
Parts 201, 204, Sections 260.1, 260.2]

Before Commissioners: Charles B. Curtis, Chairman;
Don S. Smith, and
Georgiana Sheldon

Accounting for Premium, Discount
and Expense of Issue, Gains and
Losses on Refunding, and Reac-
quisition of Long-Term Debt, and
Interperiod Allocation of Income
Taxes

Docket No. R-424

ORDER DENYING APPLICATION FOR
REHEARING OF ORDER NO. 505-B

(Issued September 7, 1977)

On July 8, 1977, the Commission issued Order No. 505-B in which it affirmed Order No. 505, 51 FPC 715 (1974), and Order No. 505-A, 51 FPC 832 (1974), by requiring that jurisdictional utilities and natural gas companies use accounting procedures which follow the rate treatment prescribed by the Commission for gains and losses from the reacquisition of debt. Texas Eastern Transmission Corporation and Interstate Natural Gas Association of America (collectively the Petitioners) filed jointly on August 8, 1977, an application for rehearing. For the reasons discussed, the Commission shall deny the Petitioners' application.

The Petitioners have raised no material facts or principles of law which warrant a change in Order No. 505-B. All of the Petitioners arguments were raised by the same Petitioners at earlier stages of this rulemaking. Those arguments were fully considered and rejected by the Commission in the prior orders in this docket. In view of the

lack of any new or convincing arguments which would require a different result in Order No. 505-B, the Commission shall deny the application for rehearing.

The Commission orders:

(A) The Petitioners' application for rehearing, filed on August 8, 1977, is denied.

(B) The Secretary shall cause prompt publication of this order to be made in the Federal Register.

By the Commission.

(SEAL)

Kenneth F. Plumb,
Secretary

NOT TO BE PUBLISHED — SEE LOCAL RULE 8 (f)

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 74-1781

TEXAS EASTERN TRANSMISSION CORPORATION,

Petitioner,

v.

FEDERAL ENERGY REGULATION COMMISSION,

Respondent.

No. 74-1784

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,

Petitioner,

v.

FEDERAL ENERGY REGULATION COMMISSION,

Respondent.

Petitions for Review of an Order of the Federal Energy Regulatory Commission (formerly the Federal Power Commission).

Before: WRIGHT, MacKINNON, and ROBB,* Circuit Judges.

JUDGMENT

These causes came on to be heard on petitions for review of an order of the Federal Energy Regulatory Commission and were argued by counsel. By order filed September 18,

* Mr. Justice Clark of the Supreme Court of the United States, Retired, sitting by designation pursuant to 28 U.S.C. § 294(a) (1970), was a member of the panel which heard the argument and remanded the record in these cases. Circuit Judge Robb was substituted for Mr. Justice Clark upon the latter's death in June 1977.

1975 this court remanded the record in these cases to the Commission for further proceedings. On December 9, 1977 a supplemental joint appendix detailing the proceedings on remand and setting forth the Commission's Order No. 505-B on remand was filed. The parties have filed briefs before this court related to the Commission's rulings on remand.

In this court's memorandum supporting the remand order filed September 18, 1975, we stated that rules issued by the Commission must be "necessary or appropriate" to the administration of the Commission's regulatory functions. 15 U.S.C. §§ 717g, 717j, 717o; 16 U.S.C. §§ 825, 825c, 825h. We stated further that since the issuance of an accounting regulation is an informal rulemaking, our only concern is whether the Commission has proceeded arbitrarily and capriciously; in its choice of means with which to achieve permissible ends.

We have examined the reasons stated by the Commission on remand in issuing Order No. 505-B in the light of this standard. We are now of the view that the accounting rule promulgated by Orders Nos. 505, 505-A, and 505-B satisfies this standard. *See Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962); *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 286 (1974).

On consideration of the foregoing, it is ORDERED and ADJUDGED by this court that the orders of the Commission sought to be reviewed herein are hereby affirmed.

Per Curiam
For the Court

George A. Fisher
Clerk

NATURAL GAS ACT

SECTION 8. (a) Every natural-gas company shall make, keep, and preserve for such periods, such accounts, records of cost-accounting procedures, correspondence, memoranda, papers, books, and other records as the Commission may by rules and regulations prescribe as necessary or appropriate for purposes of the administration of this act: *Provided, however,* That nothing in this act shall relieve any such natural-gas company from keeping any accounts, memoranda, or records which such natural-gas company may be required to keep by or under authority of the laws of any State. The Commission may prescribe a system of accounts to be kept by such natural-gas companies, and may classify such natural-gas companies and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry, and the Commission may suspend a charge or credit pending submission of satisfactory proof in support thereof.

SECTION 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after pub-

lication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours.

SECTION 19. (b) Any party to a proceeding under this act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall

apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in [former] sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, sec. 1254).

COMMENTS OF STATE OF WISCONSIN PSC

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This Commission has reviewed the proposals under the above rule making to provide deferred accounting treatment for gains and losses on reacquisitions of long-term debt, reaccounting for gains or losses from reacquisitions of long-term debt during the period 1961 through 1970 and interperiod accounting allocation of income taxes.

Deferred Accounting for Gains and Losses on Reacquisition of Long-Term Debt

After detailed consideration of such proposals we believe and strongly urge that the proposal set forth in the proposed rule making not be adopted as it is inconsistent with just and reasonable accounting provisions for public utility enterprises, is inconsistent with generally accepted accounting principles and fails to recognize the receipt of income in the year in which such transaction was completed.

In recent years gains realized by Wisconsin public utilities in acquiring bonds in the open market for sinking fund purposes at a discount have aided the utilities in offsetting rapidly increasing costs of providing utility service and have in part offset the needs for rapid rate relief. Due to the fact that with the passage of time the opportunities for such gains will likely diminish, we consider that it is unnecessary as well as incorrect to revise the present accounting procedures for gains and losses on completed transactions in connection with acquisition of debt securities to meet sinking fund requirements.

Reaccounting for 1961 Through 1970 Gains and Losses on Reacquisitions of Long-Term Debt

We consider that the proposals for reaccounting should not be adopted as the financial statements of Wisconsin

public utilities during the period 1961 through 1970 in presenting the gains and losses from acquisition of debt securities for sinking fund purposes conform to generally accepted accounting principles and the requirements of the Uniform System of Accounts and the proposal would result in reducing reported earnings previously considered by investors in appraising the enterprise. Such reaccounting in our consideration would be detrimental to the industry and the public as it would lessen the confidence of investors, analysts and others in the reported earnings of public utilities at a time when for numerous reasons public utility securities are less attractive in the market place than previously.

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COMMENTS OF STATE OF CALIFORNIA

This is a submission, in the specified original and 14 conformed copies, of the views, comments and suggestions of the NARUC Subcommittee of Staff Experts on Accounting.

The NARUC Subcommittee of Staff Experts on Accounting is currently composed of 14 members. Said membership includes representatives from 12 states, the Federal Communications Commission and the Federal Power Commission. At our semi-annual meetings, we encourage the attendance and participation of representatives of other states and federal agencies who do so in the capacity of a conferee.

At our last meeting held in Baltimore, Maryland, on February 8 and 9, 1972, the matter covered by Docket No. R-424 were discussed in detail. In attendance at this meeting were representatives of 20 states and 5 federal regulatory agencies. Representatives of the Federal Power Com-

mission in attendance at this meeting participated in the discussions on Docket No. R-424, but refrained from expressing an opinion on the proposals contained therein.

A review of the Notice of Proposed Rule Making under Docket No. R-424 indicates that the accounting for two basically different types of transactions is discussed therein. The first item relates to interperiod tax allocation and the second to the accounting for gains or losses from reacquisitions of long-term debt when such reacquisitions are not part of a refunding transaction. Each of the two items will be discussed separately.

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Accounting For Gains and Losses On Reacquisition of Long-Term Debt

Discussion on the proposed changes in accounting for gains and losses on reacquisition of long-term debt was directed so as to consider (1) the retroactive provisions of the proposed changes and (2) whether the proposed changes were necessary or desirable. As to the retroactive provisions, it was the unanimous opinion of all present at the meeting that the restatement of balance sheet and income statements for the years 1961 through 1970 to reflect the proposed method of accounting for the financial impact of gains or losses on the reacquisition of long-term debt would create a state of confusion in the minds of those reviewing reported financial results. Furthermore, it could result in a reduction in the equity portion of a company's capital structure at a time when substantial new-money financing is being undertaken and would result in the adoption of accounting procedures which are not only illogical but are contrary to generally accepted accounting principles. For these and many other reasons not set forth herein, the Subcommittee strongly opposes the adoption of retroactive

changes in the method of accounting for the gains and losses on the reacquisition of long-term debt.

A substantial majority of the Subcommittee members in attendance at the last meeting were of the opinion that no change in the present method of accounting for gains and losses on the reacquisition of long-term debt is necessary or desirable. In their opinion the proposed revision of General Instruction 17.B requiring deferral and amortization of the gains and losses on reacquired long-term debt over the remaining life of the issue is in conflict with generally accepted accounting principles. In support of that opinion, reference is made to the announcement by the A.I.C.P.A. Accounting Research Association in January 1972 that a draft opinion was being prepared for consideration by the Accounting Principles Board which would include the following statement:

"The draft will state that gains or losses on early extinguishment of debt should be reflected in the income statement for the period in which the early extinguishment occurs."

For a number of years, as interest rates increased, utilities, in meeting the sinking fund requirements of their bond indentures, have been acquiring bonds in the open market at a discount and have deposited the bonds rather than cash with the trustee. The difference between the purchase price of the bonds and their face value, adjusted for premium, or discount and expenses has been accounted for as income. Since the amounts involved in this type of transaction were rather minimal up to about 1968, the Subcommittee did not, up to then, believe that it was necessary or desirable to consider modifications to the method of accounting for the gain on the reacquisition of debt securities. In the last year or so when interest rates increased substantially and the income derived by some utilities from

the acquisition of their debt securities at a discount to meet sinking fund requirements accounted for as much as 10 percent of the per share earnings on common stock the Subcommittee again considered the matter.

While a minority of the Subcommittee is now suggesting that the gain, or loss if that should happen in future years, should be charged or credited to the unamortized debt discount and expense account associated with the particular debt issue involved and be amortized over the remaining period the security will be outstanding, the majority do not accept this viewpoint.

The type of transaction herein referred to is not a refunding operation, that is, you are not purchasing bonds in order to refund them through the use of proceeds from the issue and sale of bonds having better terms, from the utility's point of view. Purchase of bonds in order to refund them through the use of proceeds from the sale of other securities is one type of transaction. Purchase of bonds to meet sinking fund requirements is another. The transactions are different, and so should be the accounting. These comments apply only to the purchase of bonds to meet sinking fund requirements.

The purchase of bonds to meet sinking fund requirements completes a transaction — that transaction being the life cycle of a certain portion of bond issue. Since the repurchase of bonds to satisfy sinking fund requirements completes a life cycle for accounting purposes, any gain or loss realized applies to that life cycle, and that life cycle is a prior, not a subsequent, period. If it were possible to know in advance what the future holds, good accounting would require that the discount on the repurchase of those bonds that will subsequently be acquired at a discount should be amortized over the lives they actually will have. Since no one can accurately predict interest rates or other

pertinent factors, it follows that no one can know how many, if any, bonds will be available for purchase at a discount. The discount on repurchase becomes known only after it is too late to apply it to the proper accounting period. The gain or loss must be accounted for as income or loss in the period in which the bonds are reacquired. This is the way it is being accounted for now. A substantial majority of the Subcommittee do not recommend a change in the accounting instructions.

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COMMENTS OF STATE OF NEW YORK PSC

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Accounting For Gains and Losses on Reacquired Debt

FPC's proposed changes to account for Gains on Reacquired Securities *when refunding is not involved* are in conflict with generally accepted accounting principles and not necessary to achieve the purpose FPC apparently intends to accomplish; namely, proper rate treatment.

A quick reading of FPC's proposed rule making (second full paragraph on page 3) indicates that the proposed changes are in accordance with generally accepted accounting principles. This is misleading.

When debt is reacquired to meet sinking fund provisions or because a company has excess cash or for any other reason, *other than refunding*, the debt, debt discount, premium, expenses, gains, and any other related items should be removed from the books. The debt liability and certain related items (premium, discount, etc.) were recorded when the debt was issued. When the debt is reacquired and retired all balances related thereto should be eliminated as the transaction has been completed. There is no support in generally accepted accounting principles for the treatment proposed by the FPC.

Furthermore, it is not necessary to provide this accounting to insure proper rate treatment. Gains and losses on reacquired securities as well as discounts and premiums are part of the overall cost of capital and should be so considered. Generally accepted accounting principles require such gains and losses to be accounted for in the period when the debt is reacquired and retired. "Test year" regulation permits the regulatory agency to normalize such items for rate purposes if the test year amount as recorded on the books of account is not considered appropriate for regulating rates. Many other items are normalized. There is little justification for the FPC to adopt this improper accounting — it is not necessary. The test year concept adjusted for known and anticipated changes is an adequate vehicle to accomplish for rate purposes what the FPC is apparently trying to accomplish by the proposed accounting.

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No. 77-1820

Supreme Court, U. S.
FILED

SEP 12 1978

MICHAEL DOBAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1978

**INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
AND TEXAS EASTERN TRANSMISSION CORPORATION,
PETITIONERS**

v.

FEDERAL ENERGY REGULATORY COMMISSION

**ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE DISTRICT OF COLUMBIA CIRCUIT**

**MEMORANDUM FOR THE RESPONDENT
IN OPPOSITION**

**WADE H. MCCREE, JR.,
Solicitor General,
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**ROBERT R. NORDHAUS,
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Washington, D.C. 20426.**

In the Supreme Court of the United States

OCTOBER TERM, 1978

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***ON PETITION FOR A WRIT OF CERTIORARI TO
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**MEMORANDUM FOR THE RESPONDENT
IN OPPOSITION**

Petitioners contend that an accounting rule promulgated by the Commission under Section 8(a) of the Natural Gas Act, 52 Stat. 825, 15 U.S.C. 717g(a), and Section 301(a) of the Federal Power Act, as added, 49 Stat. 854, 16 U.S.C. 825(a),¹ is arbitrary and capricious.

¹Section 8(a) and Section 301(a) provide in pertinent part and in the same terms:

The Commission may prescribe a system of accounts to be kept by licensees and public utilities [natural-gas companies] and may classify such licensees and public utilities [natural-gas companies] and prescribe a system of accounts for each class. The Commission, after notice and opportunity for hearing, may determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited. * * *

1. In 1970 in *Manufacturers Light and Heat Company*, 44 F.P.C. 314, the Commission held that for ratemaking purposes, companies subject to its jurisdiction should not treat the gain resulting from their reacquisition of their own debt securities as income in the year of reacquisition, but should amortize the gain over the remaining life of the reacquired debt. Thus, for example, if Company A issued \$1 million of debt securities in 1965, to mature in 1975, and was able to repurchase that debt at a discount in 1970 for \$750,000, then for ratemaking purposes, the \$250,000 gain should not be deemed income in 1970; rather the gain should be spread evenly over the next five years. Although the Commission's rule was a departure from accounting rules generally employed by non-regulated companies, the Commission justified it on the principle that the basic objective of the ratemaking process is to match costs and revenues (see Pet. App. 113). Petitioners do not dispute the propriety of that rule in the ratemaking context.

In 1974, after an informal rulemaking proceeding, the Commission established a rule that companies subject to its jurisdiction must follow the same amortization rule in all their financial statements, which are issued to stockholders and the public generally (Pet. App. 1-96). Petitioners sought review, contending that there was no regulatory need for such uniformity, and that it would adversely affect their ability to issue debt securities. The court of appeals remanded to the Commission for a further explanation of its regulatory need (Pet. App. 97-108). On remand, the Commission issued another opinion adhering to and further explaining its rule (Pet. App. 109-118). The Commission stated, *inter alia* (Pet. App. 111, 115-117):

Use of a uniform system facilitates comparability which not only aids analysis in rate proceedings, but also assists the Commission in making accurate cost

of service determinations and helps to assure that jurisdictional utilities will state plant, income, expense and various other accounts in a similar manner.

* * * * *

*** While the rate policy under *Manufacturers* could be followed regardless of the accounting, consistency between the accounting and ratemaking not only facilitates the ratemaking process, but more importantly, is necessary to avoid financial reporting that obscures the economic realities of the ratemaking process to the detriment of investors and others relying on the financial statements.

* * * * *

*** We should not impose on the reader of published financial statements the burden of seeking out information in the Commission's individual rate docket files to finally discover that gains (losses) used in calculating reported current net income available to stockholders do not really belong to the stockholders, but instead are to be passed on to consumers in future years through the ratemaking process.

On further review, the court of appeals affirmed (Pet. App. 121-122).

2. Petitioners continue to contend (Pet. 7-12) that the uniformity required by the Commission's rule serves no regulatory need and adversely affects their ability to issue debt securities. The Commission, however, explained that in its judgment uniformity will "assis[t] the Commission in making accurate cost of service determinations" and will prevent confusion among "investors and others relying on the financial statements." Petitioners appear to

dispute that uniformity will have those effects (Pet. 10-12), but that is a judgment for the Commission and it is clearly not arbitrary and capricious.

Moreover, as the Commission noted (Pet. App. 118), there is a certain inconsistency in petitioner's contentions. On the one hand they argue that uniformity exalts form over substance and that full and accurate disclosure can be made in financial statements without such uniformity (Pet. 10-12), while on the other hand they argue that the rule will so affect the appearance of their financial statements as to impair significantly their ability to sell debt financing (Pet. 7-8). Furthermore, notwithstanding petitioners' claim (Pet. 9), petitioners have not shown that the rule has in fact produced the feared result (Pet. App. 118).²

Under Section 8(a) of the Natural Gas Act and Section 301(a) of the Federal Power Act, the Commission has express authority to "prescribe a system of accounts" for regulated companies and to "determine by order the accounts in which particular outlays or receipts shall be entered, charged, or credited * * *." Since accounting rules are largely a matter of convention, the discretion to establish particular rules, though not unlimited, is necessarily broad and should not be overturned in the

²Indeed, as the Commission also noted (Pet. App. 9), the challenged rule does not prevent petitioners from reflecting the gains from reacquisition of debt; it merely requires that those gains be amortized over a number of years rather than reflected entirely in the year of reacquisition. Assuming *arguendo* that the consequence will be to reduce reported income in a given year and to adversely affect petitioners' ability to sell debt financing in that year, the income would be reported in future years and thus presumably would enhance petitioners' ability to sell debt in those years from what it would have been under petitioners' desired rule. Over a number of years it is difficult to see what difference the rule would make to petitioners' ability to sell debt securities.

absence of a clear abuse of discretion. See, e.g., *United States v. New York Telephone Co.*, 326 U.S. 638, 655. No such abuse has been shown here.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

WADE H. MCCREE, JR.,
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ROBERT R. NORDHAUS,
General Counsel,
Federal Energy Regulatory Commission,

SEPTEMBER 1978.

Supreme Court, U. S.
FILED

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MICHAEL RODAK, JR., CLERK

IN THE
**Supreme Court of
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OCTOBER TERM, 1978

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INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
AND TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioners,
v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

**PETITIONERS' REPLY TO MEMORANDUM
IN OPPOSITION**

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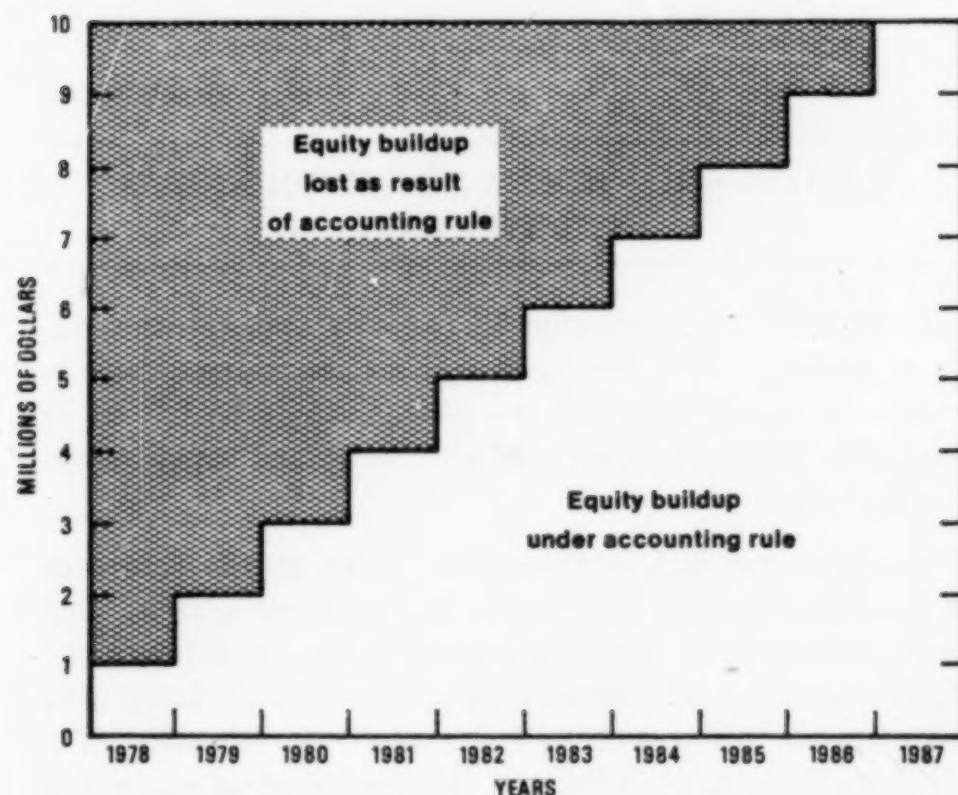
Petitioners recognize that this matter appears complex. It is precisely this fact that enables the Commission to create the impression that the matter should be left to its expertise, that it has not acted arbitrarily and capriciously. In fact, it has.

The Memorandum in Opposition picks up the reference in Opinion 505-B to the "[u]se of a uniform system" and to the matching of costs and revenues (Memorandum p. 2). These comments are diversionary. There is no issue here with respect to the desirability, indeed, the necessity, of a Uniform System of Accounts. No matching of costs and revenues is involved. The Commission knows well that these are "below the line" items. They are not matched in the ratemaking process. There is no question here

involving rates or ratemaking (see App. 103). As the New York Public Service Commission explained in its comments, the rule is neither involved in nor necessary to the "test year" concept in rate regulation (App. 132).

It may be that the Commission does not realize what it has done. After purporting to set out the consequences of the rule in footnote 2, page 4 of the Memorandum in Opposition, the statement is made "[o]ver a number of years it is difficult to see what difference the rule would make to petitioners' ability to sell debt securities".

Petitioners have apparently been unable to make the Commission see the difference the rule would make. Perhaps an illustration would help.



Debt indenture limitations customarily limit the amount of debt a utility is permitted to issue to three times equity.

The above illustration assumes a \$10 million gain as a result of 1978 transactions required to be amortized over ten years. If the \$10 million gain is reflected currently, the full \$10 million would be included in the equity account and would remain there throughout the entire ten year period. If amortization is required, only \$1 million of the \$10 million is taken into equity in the first year. An additional \$1 million is added during each succeeding year. It is this deferral that causes a permanent, irretrievable loss of borrowing capability. The equity buildup during subsequent years does not offset the reduced borrowing capability during the earlier years. The latter years' equity would be there in either event.

Under standard indenture limitations, the utilities' lost borrowing capability for any particular year would be *three times* the amount of the lost equity buildup for that year. Consequently, any financing during such "lost equity buildup" period, assuming the applicability of the indenture limitation, would have to be through more expensive equity offerings. This is one of the differences the rule makes. As stated in the Petition, it also makes capital attraction more difficult through artificially reduced earnings and interest coverages.

It is not enough for the Commission to say that the rule will "assist" it. As the Court of Appeals held in its first opinion, when the Commission promulgates a rule which changes an accounting practice in effect for many years and which deviates from generally accepted accounting principles, the Commission must explain *how* the new rule will assist it (App. 106). It has never done so. In fact, it cannot do so.

The rule is arbitrary and capricious. The Court is urged to grant the petition and full review of the matter.

Respectfully submitted,

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